PREFATORY NOTE

These transcripts have been produced from the original raw transcripts in the FOMC Secretariat's files. The Secretariat has lightly edited the originals to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcripts were not fully edited for accuracy at the time they were produced because they were intended only as an aid to the Secretariat in preparing the records of the Committee's policy actions. The edited transcripts have not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Meeting of the Federal Open Market Committee

March 26, 1991

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, March 26, 1991, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Black
Mr. Forrestal
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Mullins
Mr. Parry

Messrs. Guffey, Hoskins, Melzer, and Syron, Alternate Members of the Federal Open Market Committee

Messrs. Boehne, McTeer, and Stern, Presidents of the Federal Reserve Banks of Philadelphia, Dallas, and Minneapolis, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist

Messrs. Beebe, Broaddus, R. Davis, Promisel, Scheld, Siegman, Simpson, Slifman, and Ms. Tschinkel, Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account

Mr. Cross, Manager for Foreign Operations, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Assistant Director, Division of Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Balbach, J. Davis, T. Davis, Lang, Ms. Munnell, and Mr. Rosenblum, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Cleveland, Kansas City, Philadelphia, Boston, and Dallas, respectively

Ms. White, Vice President, Federal Reserve Bank of New York

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

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March 26, 1991

CHAIRMAN GREENSPAN. This is the first time in a long time that [the Committee membership] has been addressed as "Messrs." Who would like to move approval of the minutes?

MR. KELLEY. So move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Don Kohn will discuss the [report] of the task force on the relationship of the discount rate and open market operations. Don.

MR. KOHN. Thank you, Mr. Chairman. I can summarize our points briefly. First, the task force noted that over recent history there have been periods of fairly automatic passthroughs of discount rate changes to federal funds rates and periods in which on a number of occasions only part or none of the change in the discount rate was echoed in the federal funds rate. The first regime has tended to prevail since late 1979; the second in the 1970s. Under a borrowed or nonborrowed reserve operating target for open market operations, the passthrough tended to be automatic. When open market operations were geared to achieving federal funds rate targets, discount rate changes often flowed through but the decision was more discretionary; the adjustment was often not basis point for basis point. And when intermeeting ranges for the federal funds rate were narrow, as in the late 1970s, chances of inconsistencies were heightened and the passthrough became less frequent.

Second, we did not attempt to resolve what was meant by "pressures on reserve positions" in the current directive. Clearly, the FOMC has in mind a specific federal funds rate level. And the Desk operates with an anticipation of that level being achieved with only secondary thought given to the borrowing objective. At the same time, the Committee has deliberately avoided explicit announced federal funds targets and explicit narrow ranges for movements in the funds rate objective over the intermeeting period.

Against this background, there seems to be something to be said for at least a fairly strong presumption of a passthrough of discount rate changes in many, if not most, circumstances. Such a policy would retain one element that has fostered a degree of flexibility in federal fund rates in the 1980s, avoiding the rigidities that became built into the system in the 1970s. Inconsistencies between passing through changes in discount rates and the FOMC directive are likely to be rare. Whatever information causes the [Reserve Bank] boards of directors to vote for a change and the Board of Governors to approve the change would usually also call for an adjustment under the directive. At the same time, there _are_ circumstances in which the potential federal funds rate response to a discount rate adjustment would seem to call for a discussion by the Committee. One such circumstance might be when the change in the discount rate was _not_ intended to show through entirely; this would involve an adjustment to the borrowing objective. Another would be if the full passthrough of a discount rate change implied an especially large change in the federal funds rate between Committee meetings.

The task force suggested enhanced consultation in these circumstances. If possible, this would include advance notice to Committee members of the action contemplated and an opportunity for thorough discussion of the alternatives. Now, I'd like to give my colleagues, Peter Sternlight, Karl Scheld, and Virgil Mattingly a chance to add their thoughts. I think Peter does have a few things to say.

MR. STERNLIGHT. I don't have much to add to Don's summary. Clearly, the discount rate and the anticipated funds rate have tended to move broadly together, and I think that's to be expected given that they are responding to similar sets of information as interpreted by similar and partly overlapping sets of policymakers. Our paper tried to strike a balance between the presumption of similar movement and at the same time some recognition of the value of flexibility and discretion in those cases where full uniformity in the size and timing of moves could be questioned. Reasonable judgments may vary a bit on precisely where one draws the line as to how strong the presumption is of parallel movement. Consultation, of course, need not mean something other than parallel movement. It's just an opportunity to review the situation in light of additional information. That's all I had to add, Mr. Chairman.

CHAIRMAN GREENSPAN. I thought you gentlemen had an impossible job, and as best I can judge you came out with about the best compromise that one could conceive of. I must say I'm still quite reluctant to cave in, if you will, on this question that we can do nothing but target the federal funds rate. This issue arises largely because what we are doing de facto is targeting the funds rate. I'm not sure that any of us believes that that's the right policy. What I think this compromise does is to recognize that that is what we're doing and that it does require enhanced consultation in the form in which Don Kohn suggested. But it probably would be unwise to go to anything very specific or very detailed if for no other reason than that if we start to get very rigid in this area, we'll have to publish exactly what our guidelines are, and I think that probably would restrict our capabilities somewhat. So, as far as I'm concerned, the enhanced consultation notion strikes me as the way to come at this question in a manner which brings together what really are statutorily two fundamentally conflicting forces. If we really had to operate the discount rate independently from open market operations, we probably would get a monetary policy that was less than terrific. Indeed, I think that's the experience we had in the 1970s. If we can possibly avoid that and find a way to come off rigid funds targeting, I think that would be the ultimate solution to this problem. And even though de facto on a day-by-day basis I think we are targeting the funds rate, in the longer-term sense I'm not sure that's right. I would say that in the recent periods we probably did more monetary aggregates targeting in a sense than funds rate targeting, although operationally we were using the funds rate as the target. Considering all of that, it strikes me, frankly, that the [staff] committee has come out almost Solomon-like if that's even conceivable in this kind of situation. Does anyone else have comments?

MR. BLACK. Mr. Chairman, I agree completely with your point about federal funds targeting. I've felt for a long time that we needed to find something else, preferably some kind of reserve measure, but that's not all that easy with a lot of the parts of M2 not reserveable and with the proclivity of the financial markets for innovating if we did slap reserve requirements on those. But I think we need to move in that direction, and we probably need a little more consultation than we've had. The problem I had with the memo was that I didn't think the authors necessarily were suggesting more consultation. I think you've been unusually good in calling us together, but there have been one or two instances when I wished we had gotten together and we didn't--the change in the discount rate right before the last Federal Open Market Committee meeting, for example. One of my colleagues called and said: "You know, you've just been disenfranchised on your vote." Well, I happened to agree with that move; we were one of the Reserve Banks that had sent in [a request to lower the discount rate], and I didn't really feel disenfranchised. But he felt very strongly that that [action] had precluded the FOMC from determining the federal funds rate, which he thought was the province of the FOMC. And I can understand that argument. So, I would opt for slightly more consultation, but I think you've been better than anyone else has ever been in providing that.

CHAIRMAN GREENSPAN. Bob.

MR. PARRY. Given the current operating procedures, this recommendation of enhanced consultation makes a lot of sense. If we were to do that, I think some of the concerns that several of us felt would be much allayed.

MR. GUFFEY. I guess I don't know what the term "enhanced consultation" really means. I don't want to define it and put it in stone, but it has the right ring to it in the sense that I don't think the discount rate should dominate open market activities in the intermeeting period or vice-versa necessarily. And as a result, it does require some discussion and more frequent discussions; but whether or not this [enhanced consultation suggestion] implies that isn't clear to me. I happen to agree with Bob Black's comment with respect to the further action taken before the last FOMC meeting.

CHAIRMAN GREENSPAN. Lee.

MR. HOSKINS. I'm not sure what "enhanced consultation" means. I don't know if it means we're going to take a vote more frequently. I think the issue here clearly focused on whether or not the FOMC as a body had in some sense authorized the extent of the moves that occurred. And that was in conflict, I think, with the Board's view of what the discount rate function was. I find the statements somewhat ambiguous, particularly when I read the last page on the legal section which states clearly--at least it does to me--that the authority for monetary policy actions at least with respect to this group is with the FOMC. That's the way I read the conclusion on page 9. And that seems somewhat inconsistent with what you're suggesting. Maybe Virgil has a comment on that.

MR. KOHN. I would only comment that it wasn't clear to us and we deliberately did not attempt to specify exactly what open market operations meant. This goes back to the ambiguities as to what the directive really [unintelligible]. It was clear, I think, from 1979 to 1987 when open market operations were aimed at borrowed reserve and nonborrowed reserve targets. Now, it's less clear. So, the legal appendix didn't really help much--it didn't help me anyhow--in a policy sense of deciding what ought to happen.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. My first reaction is that in the period from 1984 to the present things seem to have worked rather well in terms of the balance that's there. Now, that's [using] the assumption that I have, which gives the FOMC certainly decided power. If the FOMC uses a borrowing or reserve target of any kind, it in effect causes certain pressures [in reserve markets], and that makes the funds rate move in such and such a way in relation to the discount rate. I don't see anything inconsistent with the FOMC deciding that they would like the funds rate to be approximately 50 or 75 or 100 or whatever basis points above the discount rate. In that scenario, if the Board with the advice of the Reserve Banks changes the discount rate, the FOMC still has the last word in the sense that they could choose to make an adjustment of the spread between the discount rate and the fed funds rate. So, it seems to me that in switching from reserve targeting to fed funds targeting, the fed funds targeting could be seen as targeting that [spread or] cushion of the fed funds rate above the discount rate. And I don't see why that infers such new territory.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Well, Mr. Chairman, as you indicated earlier, we have two statutory provisions that on the surface at least do seem to be in conflict. But I think it would be a big mistake for us to get too bogged down in jurisdictional questions here. After all, both the Board through its [oversight] of the discount rate operation and the Federal Open Market Committee [have] the same objective, and that [requires] a unified monetary policy. But having said that, we obviously need to preserve our own prerogatives in these areas. I think what is needed here, since these statutory provisions as I read them are somewhat in conflict, is to have a bridge between the two. And that's exactly what [the staff report] suggested with this [enhanced] consultation. I think that really is the way to get at it, and I would urge us to have more frequent consultations. But we ought not to get too bogged down in the rights of the Board versus the rights of the Committee. I think that's counterproductive.

CHAIRMAN GREENSPAN. Tom Melzer.

MR. MELZER. I would agree with what Bob Forrestal said about getting too technical here; I think it could be a problem. Where I would come out, because I have sympathy for what Lee said on the legal side, is that if a discount rate action causes a change in the instructions that the FOMC has given to the Desk, in a very simple-minded fashion it's hard for me in a very technical sense to let that happen without consultation. As a practical matter we are on a fed funds targeting regime now. We have chosen not to say that to the world. I think it's bad public relations, basically, to say that that is what we are doing, and I think it's right not to; but internally we all recognize that that's what we are doing. Those circumstances call for greater consultation, not less. So, I have some of the problems that were expressed earlier by Bob Black and Roger Guffey about exactly what this language means because it seems to define very little. I really don't think we could define a specific rule; but in the circumstances we're operating in right now it argues for erring on the side of more consultation, not less, when in effect we're changing the instructions to the Desk.

The other observation I would make, Don, is that I don't know how to interpret the historical evidence but, as I look back at a couple of situations that I happen to remember quite well, generally all we've done is to relate discount rate changes to fed funds changes; no one has ever looked at whether or not consultation took place. But I can remember in a strict borrowings regime--for example, in July and August of '86--there were discount rate changes that showed through to the funds rate and there was consultation with the FOMC. The FOMC basically acted at its meeting to ease policy and recognized that that might be effected through a discount rate change. I'm not saying it's possible to get it nor that it would necessarily clarify things all that much, but the evidence that we have is in some sense not the right evidence.

MR. KOHN. I think there were instances in the middle '80s period when it went both ways. Norm and I looked in the record before the last FOMC meeting and found at least one meeting in which the Board had acted right before an FOMC meeting and then another meeting several months later during which the FOMC members had a discussion such as the one at last December's meeting. So, it went both ways.

CHAIRMAN GREENSPAN. Ed Boehne.

MR. BOEHNE. I think the people who did the paper did a pretty good job. We should not be too technical in how we divide this up, and I think if we err, we ought to err on the side of more communication. Just in the last few months we've seen [a case], at the last FOMC meeting, where the discount rate came down just before the meeting. That clearly is going to rub some people the wrong way, although in the meeting before that the FOMC essentially precluded what the Board needed to do.

MR. ANGELL. That's right.

MR. BOEHNE. And the Board had to change the discount rate that day or the day after--I've forgotten how it worked. I think we're just going to find ourselves in these kinds of situations, and the way to minimize the unhappiness that shows up from time to time is to err on the side of talking rather than not talking.

MR. MELZER. One thought I meant to mention is that there's a lot of potential value added in terms of conveying any technicalities of interest to one group versus another. I think there is a potential for a higher quality decision, even though it may be more difficult to get, just through the consultative process.

CHAIRMAN GREENSPAN. Well, I think that's actually what has worked in the past.

MR. SYRON. I think enough has been said about this and I agree with the gist of what has been said about more communication. I have what may be a more technical question on this issue: Just how does having what may be close to, or effectively considered to be, a penalty rate by many people affect the implementation of policy by

Peter Sternlight? I know we've had some discussion and I'm not directly addressing what has happened, but I'm wondering as we proceed if it's worth at some point having someone crank out something on how much of an issue or concern this is for the Desk--i.e. the relationship between the funds rate and the discount rate when we're in a period such as we're in now.

CHAIRMAN GREENSPAN. Peter has obviously confronted that issue in some detail. Maybe it wouldn't be a bad idea to put down what you said orally in a short memo and circulate it. I think it's an interesting issue how the Desk--

MR. SYRON. Well, just in my own thinking about it, I would find that helpful.

CHAIRMAN GREENSPAN. Yes. Can you and Don put together something like that, Peter?

MR. STERNLIGHT. Sure.

MR. SYRON. I was thinking that as we go forward this probably won't be an issue; but if it comes up again, it would be helpful to know.

CHAIRMAN GREENSPAN. It raises an issue that Wayne Angell, who now has the floor, has raised at some length.

MR. ANGELL. I'm responding to Tom Melzer's comment because I think Tom is right at the heart of it. I turn to the operational paragraph. Now, maybe the operational paragraph is not accurate in regard to what we're doing. But if it is not accurate, maybe we ought to change it. The operational paragraph says the Committee seeks either to maintain or to decrease [or increase] the existing degree of pressure on reserve positions. That's what we say the FOMC is doing. And if we do that, we then are determining more or less the _gap_ between the discount rate and the fed funds rate rather than the level of the fed funds rate. Now, if the FOMC is determining the level of the fed funds rate, the operational paragraph doesn't say that. Frankly, I like the operational paragraph as it is. I think we can make it work well that way. But if that's what it is, then the FOMC is not in a sense determining the fed funds rate; it's determining the pressure.

MR. BOEHNE. Of course, those words are more like what we would wish the case to be rather than what it is. [Laughter]

MR. ANGELL. The thing about the discount rate, which doesn't have any notion of the Board of Governor's or the FOMC's posture that's so important [unintelligible]. We really have two policy tools. One of them is a more subtle one. That is, the open market operations can be more subtle and can have no announcement effect if we're not pegging the fed funds rate. And I think all of us would prefer to have one tool that was subtle and not announced. The other tool is an announcement tool. And it has never made much sense to me to hit the gong, to make the announcement, and to say nothing.

CHAIRMAN GREENSPAN. Does anybody else have anything to add?

VICE CHAIRMAN CORRIGAN. Just a quick comment. My basic view on this was captured very well by what Ed Boehne and Bob Forrestal said. I have just one added thought in the context of this enhanced consultation process, whatever it means, that I think we all have to be sensitive to. And that is that within the framework of a so-called enhanced consultation we have to be mindful that that process could become counterproductive if it deteriorated into people insisting upon a formal vote of the FOMC every time there was a consultation. I think we all have to have an open and flexible mind on that because if it degenerated into a process--which I don't think it will--where we ended up with frequent recorded votes in intermeeting intervals, I think that would be potentially damaging and at the extreme could produce an inertia problem with the monetary policy process itself. So, at least from my perspective, the spirit of what Ed and Bob particularly said captures it very well. I do think we have to be mindful that within the process of enhanced consultation that same need for flexibility will be there.

CHAIRMAN GREENSPAN. Anything further? If not, let's see if we can implement in some way the inclinations that have been expressed here both in the memorandum and by various members of the Committee. And we'll look back after a while and see whether or not we're doing it right; and if not, we'll recalibrate it again until we feel comfortable. I thought the [task force] report did help us in this particular area; let's see if we can benefit from it. Let's go now to the regular formal agenda and start off with Sam Cross. Sam.

MR. CROSS. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Mr. Cross? Lee.

MR. HOSKINS. Sam, you were in on both sides of the market, buying and selling. Is there some intent to re-establish or confirm target zones by the G-7?

MR. CROSS. No, I think it's more just an indication of the events of this period. Certain parts of the Treasury had at times shown a keen interest in trying to get some G-7 interest in something approaching [that], but I wouldn't say target zones. But there has been a considerable reluctance on the part of the other G-7 members to do this. I think the intervention that we saw in this period was really not so much a concern about the specific level that the dollar had reached as it was the fact that the dollar had moved up very, very rapidly--by about 16 percent in a few weeks. At times the markets were really quite disorderly. Last Thursday there was a movement of six pfennigs in one day. And the markets were very unsettled at times also in response to the proposals, specifically by the Germans, to participate in some coordinated intervention because of their concerns about the threats on the mark.

CHAIRMAN GREENSPAN. Other questions for Sam? If not, would somebody like to move to ratify the transactions?

MR. ANGELL. Mr. Chairman, I would move without enthusiasm.

CHAIRMAN GREENSPAN. So recognized. Is there a second?

VICE CHAIRMAN CORRIGAN. I second.

CHAIRMAN GREENSPAN. Without objection. Sam, do you want to go forward?

MR. CROSS. Well, Mr. Chairman, to move to another subject: Questions have been raised about the level of U.S. foreign exchange balances and whether it would be appropriate to take some moves to reduce those balances. I would like a few minutes to discuss this matter with the Committee, if I might. The U.S. authorities combined --that is, the Federal Reserve and the ESF--now hold marks with a market value of about $30 billion and yen with a market value of about $18 billion.

Let me mention some of the pros and cons of having these balances. First, on the positive side, looking at it from the perspective of where I sit, there certainly are some distinct advantages of our owning for the first time ever substantial currency reserves. Without having to belabor the obvious, not having to depend on the Bundesbank and other foreign central banks for all our financing at times of need gives us a great deal of independence as well as more of what I would call policy flexibility to deal with any exchange market flare-up, without necessarily having to change some of our policies at a time when that might not be wise or appropriate. Also, I would say that's one reason we got through the heavy downward pressures on the dollar that we faced in February that I just described--and got through it really with relatively little pain and anxiety compared with previous problems of that sort. A lot of that had to do with the fact that we have more credibility and more market confidence because we do hold substantial balances. The market is aware that we hold them and that we are able to take action if we want to. I think that did help to keep the dollar's decline from getting out of hand at a time when our currency was at all time lows. Also, I should say that our currency balances, which are certainly far higher than ever before, if compared to international standards in other countries don't really show as a high currency reserve currently.

On the negative side, our reserve holdings do entail exposure to the exchange rate risk. At present the ESF and the Federal Reserve combined have a cumulative net profit--that's the difference between the present market value of our currency holdings and the acquisition value--on our currency balances of around $4 to $4-1/2 billion of which the Federal Reserve share of the profit amounts to about $3.2 billion. Of course, we regularly mark-to-market on these balances, and these translation gains have already been reflected in our balance sheet. This means that the Federal Reserve's share of the profits have been used when they were accumulated to increase the level of Federal Reserve profits that we hand over to the Treasury. Accordingly, if the exchange rate moves up from this point, the level of those cumulative profits declines. Only if the dollar goes down does this [backtrack] the other way. And if the dollar goes up, that reduces the Federal Reserve profits going to the Treasury. There's a concern that this exchange rate exposure and the possibility of these translation losses could lead to public and Congressional criticism. There is no real loss in terms of the interest these days. Our interest rates are presently below those of both Germany and Japan; [so that goes] the other way.

If there were a need to cut back on our currency balances, it seems to me it's important that we have a clear and well understood rationale for the action. Of course, we could reduce them by more active intervention operations and that's perfectly understandable. But if we simply adopted a conscious policy of getting rid of a substantial part of our reserves, it seems to me that that could be seen by the market and by foreign officials and by the general public as a move by the United States toward withdrawal of its role in international responsibilities and its role in helping to maintain the stability and smooth functioning of the [international financial] system. One possible rationale for selling reserves other than through our intervention operations is to unwind some more of the warehousing. Last year we did succeed in selling off a substantial amount of foreign currency balances as part of the unwinding of the warehousing arrangements with the Treasury. We sold some both off-market and on-market and we explained it publicly after the fact. That did not cause problems and was accepted as a reasonable and understandable action to reduce the warehousing; it is generally agreed that drawings under the warehousing are not to supposed to be permanently outstanding.

Another possibility would be to adopt an approach of selling the earnings on our reserve holdings from time to time as we have the opportunity and putting those out into the market or elsewhere as conditions permit. Other nations sometimes follow approaches not too different from that. For example, the Germans accumulate their troop dollars in this manner and then feed them off; they may keep them for a considerable period and then feed them off into the market even when it seems desirable to do so or when conditions are favorable for absorbing them without market disruption. Similarly, we might look for opportunities to make sales to other central banks whose reserve needs might be complementary to our own. So, an approach of some sales along these lines for reducing the warehousing or for disposing of some of the earnings would provide some considerable scope for flexibility in disposing of some of the balances. However, at the moment, I should say that the prospects for such sales are not very encouraging. With the dollar strengthening very sharply, neither the Germans nor the Japanese would like to see us putting more mark or yen balances into the market under present conditions. Also, the Bundesbank has just paid a substantial amount of its dollar reserves to us for its Desert Shield contribution and that, as well as the intervention, reduced their dollar reserves. And the Bank of Japan has just paid us a little under $6 billion in dollars as we converted the yen that they have contributed for the Desert Shield operation. In light of these circumstances, I would suspect that neither of those central banks is likely to be interested in either further off-market exchanges right away or market [sales]. But over time we could think of ways to utilize some of these currencies along these lines and ways to provide us some more flexibility if that is the Committee's wish. Thank you.

CHAIRMAN GREENSPAN. Questions for Mr. Cross? President Boehne.

MR. BOEHNE. If this warehousing arrangement with the Treasury were unwound, how much would that reduce total U.S. balances?

MR. CROSS. The Treasury's present warehousing is $4-1/2 billion. I think they would not be happy to reduce it totally, but we did reduce it by a considerable amount last year, and I think some further reduction would certainly be possible.

MR. BOEHNE. Assuming for the moment that we want to be a major player in the foreign exchange market and have enough ammunition to play those type of wars, what [amount] of reserves do we need to have a credible balance? Setting aside the amount we have now, if you were starting out as a strategist, what amounts do you think we would have to hold to get respect from the market?

MR. CROSS. Well, it's very difficult to be at all precise in this.

MR. BOEHNE. You don't have to be precise.

MR. CROSS. Even in interest it's hard to say how much--

MR. BOEHNE. $50 billion, $20 billion, $100 billion?

MR. CROSS. Well, I really do think it's difficult to set a specific target level. It seems to me that the reserves that we have accumulated as a consequence of what we've done and not done--. One of the problems is that it's very difficult to say we don't need $48 billion, we need $42 billion or $55 billion. It's very hard to justify that kind of decision, it seems to me.

CHAIRMAN GREENSPAN. I think Ed is raising a question involving three choices: $20, $50 or $100 billion.

VICE CHAIRMAN CORRIGAN. Right.

MR. CROSS. $50 billion.

CHAIRMAN GREENSPAN. Governor Mullins is first.

MR. MULLINS. I guess Ed was getting at what I wanted to ask which is not the number but: What conceptual basis is there for determining an appropriate balance? Could we start with that and then think about what that means in terms of numbers?

MR. CROSS. Well, as I say it's very difficult to know the kind of reserve needs we may have because we don't know what circumstances we're going to face. The fact that we have them in a sense makes it less necessary to use them. So, to impress the market and to impress the rest of the world, it seems to me we need a substantial level--along the lines of what we have. Our reserves are not high relative to, say, those of Germany or Japan or even Taiwan, which of course has the highest in the world. By most international standards we do not have a level of reserves that shows us to be excessively endowed by these kinds of comparisons. You can argue how much the United States should have, given its position, whether that's more or less. But it seems to me that the United States should be up with the big players, as it were, and that we should have amounts that don't look quite small relative to what other major countries have.

MR. MULLINS. It does seem to me that we're kind of at sea unless we can think a little more precisely about the conceptual basis.

CHAIRMAN GREENSPAN. If I may just piggyback, it's not that we have in the past always had to go to foreign central banks to borrow currencies for intervention. We did, remember, have a period when we actually went out and sold Swiss [franc and] deutschemark denominated Treasury securities to raise those funds in the markets.

MR. CROSS. That's right.

CHAIRMAN GREENSPAN. We do have alternative means of accumulating currencies should we need them. It's not only the level [of our foreign currency holdings that matters] but our standby options [to acquire more] to meet alternative rather than prespecified requirements. In other words, it's not an issue of just having inventories of some physical commodity which when they get to zero it means something. It doesn't mean that much in foreign currencies, if we have a realistic capability of borrowing fairly substantial quantities in open markets. And I think that's an issue [relevant] to what Governor Mullins is raising in terms of the conceptual framework.

MR. CROSS. You also need the cooperation in order to borrow, and that's what we obtained the last time. But it takes time and so forth and so on. Obviously, the ability to borrow in the open market is one potential source.

MR. MULLINS. As an aside, how much have we lost over the past six weeks in value?

MR. CROSS. Well, we intervened in the amount of $1.4 billion during the February period; that's the only intervention.

MR. MULLINS. Not intervention. What is the change in market value in the past six weeks?

MR. CROSS. Well, I don't have the precise--

MR. MULLINS. Is it $5 billion or something like that, would you guess?

MR. SIEGMAN. In the past six weeks, on the balances of DM the United States in total lost approximately $3 billion, not including yesterday's appreciation. And on the yen the United States lost close to $1 billion.

MR. MULLINS. And we will report that? So, it's the same order of magnitude as 3 or 4 big S&Ls?

MR. SIEGMAN. But those are unrealized [losses].

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. I'm not clear about what the point is. Are you seeking advice on what to do with this stuff?

MR. CROSS. Well,--

MR. HOSKINS. I'll repeat where we started, or at least where I started in late '87 and early '88: The discussion around the table at that time, as I recall it, was that there was some sense of agreement in some parts of this body that in large open economies sterilized intervention does not impact exchange rates over time and that, therefore, intervention is nothing but churning and noise to the market and it can interfere with our policy efforts. At that time the argument was--and I think it was an appropriate argument--that we ought to have some [foreign currency balances] at least for cooperation purposes, to show the flag and to be part of this process. But then we were talking about less than $10 billion. If I remember correctly, that limit moved up and there was a dissent at $12 billion; then it went to $15 billion. And now we have backed ourselves into a situation here where we're turning this accumulation into a rationale. There was no rationale; we just did it. And for a body that has some concern about Congress and its inspection of the Federal Reserve and its willingness perhaps to change the Federal Reserve Act it seems to me that we're in a bad situation if we continue to run these kinds of potential losses plus the warehousing. I think that's a potential problem for us as well. So, if you're looking for recommendations, I would bring [our holdings] back down to some level where we can show the flag and be part of the process but where we don't expose ourselves to the other kinds of political difficulties.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Sam, what was the maximum dollar guide on these holdings before we began to pull back on the Exchange Stabilization Fund? What was the maximum you said we--

MR. CROSS. $15 billion. Do you mean the amount of the warehousing?

MR. ANGELL. No, what was the maximum market value of the total Federal Reserve and Treasury holdings of deutschemarks and yen?

MR. CROSS. Probably $53 billion; I don't have the precise number, but I would say around $53 billion.

MR. ANGELL. All right. So, if you want to be able to buy and sell--you feel some handicap in regard to being that close--do you see the $53 billion as kind of a ceiling?

MR. CROSS. Well, I don't see that $53 billion particularly as a ceiling or anything else. I don't see any need for us to continue to accumulate [foreign currency] reserves, if that's your question.

MR. ANGELL. Let me put the question another way. Let's suppose in the process of officially determining the U.S. foreign exchange position that there is more of a tendency to want to intervene when the dollar is strong than there is to intervene when the dollar is weak. Let's suppose we had that kind of posture officially. What would tend to happen to the size of your fund over time if you're operating in that circumstance?

MR. CROSS. Well, you've asked a rhetorical question. But it seems to me the question is whether you agree with the approach on the intervention, not the question of what is the level of reserves.

MR. ANGELL. No, I'm asking what would happen to the size; I think you know the answer, Sam. What would happen to the size of the fund?

MR. CROSS. If we always intervened when the dollar rose and never intervened when the dollar fell, our reserves would accumulate.

MR. ANGELL. They would accumulate. Now, some of us are not quite as purist as Lee is on the intervention issue, although I do understand Lee's position. But if we get ourselves in the circumstance where we are selling yen and deutschemarks when the dollar is weak and is very low by any measure of purchasing parity estimations, no matter how bad they are, then how in the world are we going to get the size of the fund down so that when the mark gets to 200 or 220--? I presume you're going to want to be buying deutschemarks then. Is that the general assumption?

MR. CROSS. You're not getting any assumption from me. What I was talking about was the possibility, if the Committee has the desire, of looking for occasions to feed out some of these currencies as we did last year. We could look for opportunities to put them out in ways that don't have an exchange rate effect--just sell off a few and announce that the only [reason] that we are [selling] is to help bring down the warehousing or that we have an approach of disposing of some of the earnings from time to time. That was the concept I was--

MR. ANGELL. Well, Sam, I guess I'm really asking you: Do you think it's possible or do you know of a way that we can bring more balance to the game in terms of [as much] enthusiasm for buying dollars as we have for selling dollars?

MR. CROSS. Well, I do think that's more a question of the approach to intervention than of reserve determination.

MR. ANGELL. I think I know Sam's answer to these questions.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, for starters I'd say that I am not inherently troubled at all by the fact that the Federal Reserve either on its own or in collaboration with the Treasury has foreign currency balances; that doesn't bother me at all. The only point where that would bother me inherently would be if the mere fact or size of those holdings in and of themselves tended to undercut the role of the dollar as the world reserve currency. That I would have an inherent problem with. And I don't think that condition is within sight. Now, that's kind of my breaking point. But having said that, the question comes up: What is reasonable and what is unreasonable? I don't know the answer, either. But I do think we should keep in mind that as recently as 1977 or 1978--I forget which year--when the perception was that the United States was going in the tank, the United States government, including the Federal Reserve, found it necessary to approach the world at large, hat in hand, and establish what was then a $30 billion war chest. To be sure, a lot of that war chest was smoke and mirrors and some of it was subsequently financed as you pointed out through the so-called Carter bonds. But the Carter bonds were hardly a great victory from the point of view of the United

States either in political or in economic terms. So, I think there is a lot to be said for the war chest theory.

In terms of the size issue, the fact of the matter is that in the late 1970s when the world was a lot smaller than it is today what was thought to be a reasonable war chest--again recognizing that a lot of it was smoke and mirrors--was a fairly substantial amount. That [leads] me, as does the point that Sam made about the currency holdings of other central banks, to the view that in rough orders of magnitude the balances we hold right now don't seem unreasonable. In terms of the question of whether they should go up or go down, my instinct is that if they stay roughly the same or maybe even go down a little, that's fine so long as the reasons why they are going down are credible. And here I must say that I worry a bit about undue--and I want to emphasize that "undue"--preoccupation with net losses and net profits. I don't hear anybody asking Mr. Sternlight how much money he lost for us in the past six weeks when the long bond went down 5 or 6 points in price or whatever it was.

CHAIRMAN GREENSPAN. That's a good question, Peter!

SPEAKER(?). Why didn't you sell those bonds before they lost value?

VICE CHAIRMAN CORRIGAN. I suspect though, Peter, that the amount was not inconsequential in the time-frame of the past 5 or 6 weeks. So, I think we have to be a little careful about latching on to the star of profitability because--

CHAIRMAN GREENSPAN. There is a difference, Jerry. U.S. government consolidated purchases that the Federal Reserve--

VICE CHAIRMAN CORRIGAN. Well, the precedent in my judgment is not inconsequential. I understand your point and that's why I didn't want to overstate the argument. [As I] say, I think we have to be careful about making a public argument for disposing of balances simply on the basis of trying to maximize profits or minimize losses. I think that would be a mistake. On the other hand, if the specific suggestion is something along the lines of what Sam said--and as I heard Sam he was saying two things--one is that in a orderly way maybe we can try to wind down the warehousing and two is that maybe we ought to have in mind trying to work off the earnings. I wouldn't be wildly allèrgic at all to something along those lines because I think he could make a fairly coherent statement, including to our colleagues abroad, as to what we're doing and why we're doing it. But at the end of the day--I think Lee Hoskins touched on this--what is very, very important here is that whatever we do and however we do it, it should not be allowed to be construed by anybody as even carrying the remotest threat that the Federal Reserve or the United States is copping out in terms of international relationships, particularly the kinds of not very aggressive but nevertheless cooperative intervention that we've seen in the past six weeks, for example. I'm not at all troubled that we [were] on both sides of the market within a six-week time-frame. In the first case it was in a context in which a number of us were worried that the dollar was about to fall out of bed. Whether you agree with that or not, we did look to our friends abroad for a little help and they gave it. And it doesn't seem to me at all credible for us to say "The hell with you" six weeks later when we got this unbelievably dramatic change in psychology and they turned to us and asked if we were willing to help out a little, even if it's symbolic. I just don't see that as viable. So, I would be careful here. But if I understood what Sam was saying in operational terms, I certainly wouldn't have any problem with the thrust of his suggestion.

CHAIRMAN GREENSPAN. Roger.

MR. GUFFEY. To raise an old technical question maybe, given that we neatly divide the holdings between the Treasury and the Federal Reserve: Do we have sole authority to determine the foreign currency holdings of the Federal Reserve System or is this a national policy that must be coordinated with the Administration? Where do we stand? Can we just sell off $24 billion of mark and yen and forget it if we want to?

MR. CROSS. Are you asking in the legal sense or the policy sense?

MR. GUFFEY. How does that [differ]?

MR. CROSS. Legally, it is set by the Committee. We have a limit of $25 billion in exposure, which is the maximum that we can--

MR. GUFFEY. Well, let me put it another way: Can we sell off $48 billion, which is the Treasury's holdings as well as our own?

MR. CROSS. No, the Treasury's holdings are part of the ESF and subject to the determination of the Secretary of the Treasury.

MR. GUFFEY. If we were to choose to sell off $5 billion of our own, how do you maintain the 50/50 split between the two?

MR. CROSS. Well, we and the Treasury have a different amount of [foreign currency] reserves at the present time. We have a higher level of reserves partly because of the warehousing. But even excluding the warehousing we have--do you have the number, Charlie?

MR. SIEGMAN. We have $26.5 billion and they have $22 billion.

MR. CROSS. We have about $26 billion and they have about $22 billion. So, there are some differences. But, as you know, the policy has been for a long time to try to pursue these things together and to work jointly. And almost all of our intervention has been financed that way. Certainly, the Treasury is very happy with that arrangement and would be very concerned if there were a proposal to go off on a different track.

MR. SIEGMAN. Although on intervention policy the Treasury has the mandated authority--

MR. GUFFEY. Yes.

MR. SIEGMAN. --and we have to consult and work in conjunction with them.

MR. CROSS. On the intervention the Treasury has a stronger hand.

MR. GUFFEY. Well, the answer to my question then is that if we decided to reduce our Federal Reserve holdings of foreign currencies, this Committee could do that and you could effect it.

MR. CROSS. The Committee has the legal authority to set the maximum holdings that we have.

VICE CHAIRMAN CORRIGAN. But as a practical matter, Roger, if the Committee were of a mind to sell $5 billion equivalent of D-marks tomorrow morning, I think we would have to consult with the Treasury; indeed, I think we would feel an obligation to consult with the Bundesbank as well.

MR. CROSS. Well, it would be inconceivable that we would do any such action without working with the Treasury. But also we would not just be selling off other countries' currencies without working it out with them. When we did the $2 billion last year we did work it out with the German authorities so that it could be done in a way that didn't cause problems for them and their markets. But we're now in a different market situation.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. On the point of the rationale for these things that Lee mentioned, it seems ironic that the world's primary reserve currency country might be trying to measure its own international clout in terms of its holdings of foreign countries' currencies. It just seems a bit inconsistent and ironic.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. David Mullins asked my question.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. As a practical matter, I think we around this table are going to find that we have to intervene from time to time, and that means we need a war chest. And it would be best if we could arrive at some rough amount that we feel comfortable with, intellectually or conceptually. But we aren't getting very far in that direction, and perhaps we won't. If your brain doesn't lead you somewhere, then you've got to go with your gut feeling. My gut tells me that we ought to unwind this warehousing arrangement as best we can. I think $48 billion is on the high side and my sense tells me that we ought to look for some opportunities to lower that number. I don't know how far we ought to lower it but a lower number would make me feel more comfortable; I doubt if we need $48 billion. So, in the absence of some conceptual framework, if Sam is looking for advice, I would say: Talk to the Treasury and reduce the warehousing and take advantage of some opportunities to reduce the $48 billion in other ways.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I'm going to overlap a little with Ed and agree with David. When we started off a couple of years ago, in the beginning the idea of that foreign exchange study was to see whether we could develop some rationale. It turned out to be very effective because I think the weight of that effort slowed down in a broad sense the propensity of the Treasury to intervene, but we never answered the threshold question. I'm not sure there is any answer in a number sense but conceptually there's probably an answer. And I think we have to be prepared with that because there's the potential for some heat here and with good reason.

CHAIRMAN GREENSPAN. I think we'll get hearings on this.

MR. MELZER. Longer term, I think we need to pursue that; there are some international financial considerations that the people who are going to be taking the shots at the profit and loss statement don't really appreciate. So, I think we can do an educational job and we have to be ready to do that well. Longer term, I suspect the problem is that most of us feel that sterilized intervention doesn't really do any good and yet we're caught in a sort of international alliance in which some of our counterparts do. So, in order to play in that game, we do something that we don't fundamentally believe in. We're not going to answer that today but I don't know what the dynamics are that perhaps ultimately will lead to more sensible combined behavior in that regard internationally. As a practical matter I agree that we have to play the game. We can't just say that we think this is stupid, that it doesn't work, and we're not going to do it. Maybe over time there are efforts we can make to lead the world to perhaps a more sensible approach on this. Maybe that's idealistic; I don't know.

CHAIRMAN GREENSPAN. Let me ask Sam a question, which in a sense comes out of this discussion. Your argument for a war chest and some of the concern on the negative side is the associated price risk since the interest rate risk--or I should say the interest income is level. Is there not any mechanism by which we can create swaps or RPs or something of that nature in which essentially we have fixed the exchange rate of our holdings? Is there a way in a sense to have a [unintelligible] put back to the originator of a currency so that, for example, at this particular stage we would have a deal with the Bundesbank where we would match certain parts of their dollar holdings and an equivalent part of our DM holdings and agree that that is a swap at a fixed price and eliminate exchange rate fluctuations, which affect--

MR. CROSS. I'm not sure I understand. We could obviously--and we have done so--enter into exchanges with the Germans and others to give them back a portion of their currency and receive back a portion of our currency. The kind of facility you're talking about, if I understand it, sounds like what the swap was originally intended to do.

CHAIRMAN GREENSPAN. Well, the only difference is that the currency moves after the agreement. What I'm asking is: Can we move the currency retrospectively in a sense or agree at this stage that--? I'll give you a specific case. We basically are saying that the $10 billion deutschemarks and the equivalent of yesterday's exchange rate in dollars held by the Bundesbank are presumed to have been fixed-price swaps which we will at some point unwind at that exchange rate. It gives us the cushion but it doesn't give us the exchange risk.

MR. ANGELL. You could have an exchange of puts. In effect, you could swap puts and thereby assume that somebody would ultimately want to exercise that added advantage. And that would effectively accomplish what you want to accomplish.

CHAIRMAN GREENSPAN. There are lots of ways of doing that.

MR. CROSS. It sounds like a forward exchange transaction. I'll be happy to try to think and see if there--

CHAIRMAN GREENSPAN. Well, the point at issue is that it's a [forward] exchange transaction that has a date on it.

MR. CROSS. Right.

CHAIRMAN GREENSPAN. And effectively that gets factored into the market and neutralizes your position. What I'm thinking of--and I just thought of it this moment, so there might be plenty of reasons why not--is an open-ended fixed-price mutual put, to put it in the terms that Governor Angell stipulated, so that we can eliminate part of the problem that is on the negative side of the current--

VICE CHAIRMAN CORRIGAN. It can at least take off the tail, I suspect.

CHAIRMAN GREENSPAN. Yes.

MR. CROSS. We'll try to think that one through.

CHAIRMAN GREENSPAN. Okay. In the interim, unless I misheard, at a minimum there is support here for trying to edge the stock of foreign currencies down either by unwinding some of the warehousing and/or selling interest receipts into the market if that is at all feasible. In today's environment I'm not sure how much we could do of that, but clearly something is going to show up. I certainly didn't hear anyone here support a significant increase; we are pretty much biased in the other direction.

MR. BLACK. I think there probably would be a preference for unwinding the warehousing first, too, Mr. Chairman.

CHAIRMAN GREENSPAN. [Unintelligible] warehousing because that implied an issue for opening up [talks] with the Treasury, which we have to do. And I think we are in the process of discussing that. Hopefully we may succeed.

MR. BLACK. We might be able to couple that with opposition to letting the FDIC borrow $25 million from us and get a credit--

MR. HOSKINS. That's an idea. We'll give them the deutschemarks!

SPEAKERS(?). Good idea!

CHAIRMAN GREENSPAN. Give deutschemarks to the FDIC?

MR. BLACK. That wasn't really what I had in mind, but that's an interesting fallout.

CHAIRMAN GREENSPAN. If that doesn't get somebody's attention!

MR. BLACK. I bet it would too. I was just thinking about the monetary policy accord in the early '50s. We need a credit accord too, where they don't try to dictate the composition of our assets, which is what the FDIC maneuver does and what this warehousing does.

CHAIRMAN GREENSPAN. Well, we will be discussing this.

MR. BLACK. Yes, I didn't mean to get ahead of you.

MR. MELZER. I was just going to ask how you would characterize the conversations with the Treasury on reducing the warehousing so far. Have we been pushing hard on them and have they been reluctantly going along or are they going to sit there and say: "Why didn't you tell us to sell this stuff?" How have those communications gone?

CHAIRMAN GREENSPAN. Why don't you go ahead, Sam.

MR. CROSS. Well, I think the Treasury is sympathetic to some reduction but they are not talking about getting rid of the whole warehousing amount or anything like that. This hasn't gone through all their [decisionmaking] processes but the discussions that have taken place so far indicate some willingness, certainly, to consider some decline in the warehousing; but they're not talking about the whole amount.

MR. MELZER. And have we had to push them hard to peel off what has been sold already?

MR. CROSS. Well, I'm not sure I understand. We could--

VICE CHAIRMAN CORRIGAN. The answer is "no," Tommy.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. There's one slight addendum to this discussion: We have a reserve holding that costs us more money than what is reasonably in prospect to happen on foreign exchange rates and that is that we really are not a small reserve holding currency country. I think we actually have official reserves of $85 billion, Sam, compared to Taiwan's $75 billion. And if you mark our gold to the $358 price, we end up with something like $170 billion. There are opportunity costs because we don't get interest on that gold as we do on our foreign exchange [holdings]. That cost is out there also. I would hesitate for us to have foreign currency holdings that have swap puts that just sit there, [which] is now becoming the case for our gold.

CHAIRMAN GREENSPAN. Charlie.

MR. SIEGMAN. I just want to bring to your attention also, as you may have heard, that Congressman Gonzalez has raised all kinds of concerns about the ESF and Federal Reserve holdings. He is proposing fueling that in a Congressional setting--tying all the accounts to the IMF legislation and other sorts of problems here. It's very much on his mind and his staff is making noises to that effect. So, it's not an academic issue of what happens to our balances; it has some other political dimensions.

May I just have one other word about the discussion? The problem is that the level of the balances and disposal of the balances are two separate items. As we just discovered, even when we agree we have too much, it is very difficult to sell except at a time when the dollar is under very severe downward pressure. If the pressure is in the other direction, upward, the other side is very concerned and the timing is not right or, as currently, we have other financing problems in other countries. So, the problem of the disposal is as difficult as the issue of the level. The other point that I think deserves at least to be mentioned is that there's always room for replenishment. It's a two-way situation. If one does dispose of a certain amount and feels one needs more, when the market situation is right there is a chance through intervention to acquire additional holdings.

One final comment with regard to the method of sales and whether it's off-market or on-market: On-market sales are equivalent to intervention in the broader scheme of things. If you do affect the market at all, within a certain time it could be neutralized; whatever effect it has is the same. But when you have off-market sales the timing has something to do with the interpretation of whether you have a target for your rate. And you do influence your co-central bankers of whether you're trying to protect a rate and not have it go higher or lower. And that again complicates the matter of disposal.

MR. SYRON. One minor point though, Charlie. I understand what you're saying and it's relevant to something Governor Angell and also the Chairman said. In a sense over time the natural tendency, then, will be to accumulate more and more reserves. That's the direction it will go in. So the cost of holding them, presuming we had a conceptual framework where we model all this, is not completely symmetric in the sense that at least under current arrangements we can borrow if we need to. Well, apparently we can; I know it's not always possible, [but generally] we can borrow if we need to get [foreign currencies] but at this point in time we don't have a mechanism for disposing of them when they get to a certain level. So, that [leads me to] a judgment--I realize this isn't precise--that as we proceed our bias should be to sell as these [balances] begin to accumulate, given the difficulty of selling as compared to accumulating.

MR. SIEGMAN. Well, as Sam just pointed out, we are in some sense a victim of historical accident. The year when we really accumulated huge amounts--$22 billion--was 1989. Without that the numbers would look very different, even if you adjusted $22 billion [down to make it comparable] to other years. So, that was the year that we probably overbought.

CHAIRMAN GREENSPAN. I think we had a very short window earlier this year, when we could have done a significant--my impression was upward of $10 million deutschemarks--off-market swap with the Bundesbank. But that window closed very quickly on us as the markets began to move. What it required was the Treasury to go along, [not] for this body to go it alone. And by the time we got the system [greased] the market had run from us and made the issue moot. There are windows, but they're very narrow and I think rare. I did speak to Karl Otto Poehl at the Bundesbank, and he seemed inclined at that stage. Now at this point I don't know; I don't know what else is going on. But there are times when large transactions could be made if we chose to do them.

MR. SYRON. It's not much, but it does seem germane to what you said. I think the [view] of the Committee would be that if such a window should open up in the not too distant future, you wouldn't necessarily want to take the time for very extensive [consultation] with the Committee. I would interpret this discussion to mean that the Committee would be happy to have that happen.

CHAIRMAN GREENSPAN. No, [the reason for the delay] wasn't this Committee but [the Treasury.] Any further questions?

MR. HOSKINS. I just had one. In your earlier report, did you talk about a swap with Romania that was paid back?

MR. CROSS. Yes, by the Treasury.

MR. HOSKINS. By Treasury, not--

MR. CROSS. It was a Treasury participation in a European BIS swap. It was outstanding for about a week.

CHAIRMAN GREENSPAN. Peter Sternlight.

MR. STERNLIGHT. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Do you want to go back and change [your prepared statement] to make sure that what you have written is now--?

MR. STERNLIGHT. [Unintelligible. Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Mr. Sternlight? Lee.

MR. HOSKINS. Just a question on whether anybody, in terms of the market participants, is looking at money. When do you think that would be a concern, if it isn't now?

MR. STERNLIGHT. Well, they certainly had been looking at it and they had noted the concerns that the Chairman and others expressed when we were in the period of very slow growth. The close attention to it seemed to fade as they no longer were looking for slow money growth as a reason to be expecting further easing moves. I wouldn't say that I'm hearing any concern about an excessive pace of money growth at this point. What I hear more is along the lines of: "Well, it looks like your M2 measure is getting into the middle of its range and isn't that nice."

CHAIRMAN GREENSPAN. Si Keehn.

MR. KEEHN. Peter, with regard to the discount rate: I must say I find it a little awkward to have the discount rate and the fed funds rate at the same level, given our interest in trying to encourage at least the visibility of [the discount window]. If we were to reduce the discount rate and make an argument that it was absolutely just a technical change to reestablish the [alignment with] market [rates], would the market buy it or not?

MR. STERNLIGHT. I think it would. That thought could be put into the language [of the press release about] a discount rate change so that they wouldn't look for any change in the funds rate. On your first point, though: While I realize there are others like yourself who have that sense of discomfort, it has not been an impediment to our operations to have the rates right on top of one another. And even with respect to the point we make about wanting to see a little more use of the discount window, I'm not sure I see it as that much of a problem because at the times when banks would come in to use the window we'd typically be getting some pressure on the funds rate. So, whether it's being lifted from a 6 percent base or a 6-1/4 or 6-1/2 percent base, I think there would still be that same incentive to turn to the window rather than pay such funds rates.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Peter, would there have been a difference if we had not sent out the signal that borrowings were sort of okay? To what extent is the way we've accommodated to this due to the slightly different signal about borrowing?

MR. STERNLIGHT. I think that little signal on borrowing probably helped to trim some of the volatility that might have [occurred] on a few days in the recent period.

MR. ANGELL. Since this has worked in some ways better than some might have anticipated, what might happen if the Committee at some point in the future--I'm not suggesting now, but sometime in the future--wanted to go 25 or 50 basis points lower on the fed funds rate [than] the discount rate and we had at least this generous an attitude about the window? Would that possibly be a workable environment?

MR. STERNLIGHT. It might be a little more awkward than what we have now. I still think it would be workable; there might perhaps be a little more volatility in the funds rate, but I'm inclined to think it would not be impossible.

MR. ANGELL. What you're saying then is that if there's some reason the Committee at some point in time wished to do that, you would not be alarmed about at least seeing what that's like?

MR. STERNLIGHT. That's right.

MR. MELZER. Wished to do what, Wayne? I didn't understand.

MR. STERNLIGHT. Have the funds rate a 1/4 or--

MR. ANGELL. I chose not to call it that.

MR. SYRON. I find this whole issue of where we are on the discount rate compared to the funds rate very interesting and one that I don't completely understand in terms of the market's reaction to it. In that regard, Peter, I just wanted to ask: Is there confusion out there when you read the screens and you see all of these comments that people are making, particularly given the strength of the dollar, about expecting that something might be done on the discount rate just for alignment purposes? I'm not saying we should change procedures here, but at some point it would be nice if people knew what we were intending or not intending by this whole situation. But maybe there isn't this confusion in the marketplace.

MR. STERNLIGHT. Well, as I commented in my remarks, there were a few days after the move on March 8th when the market perceived that funds were going to be trading more likely around 6 percent. And with the discount rate at 6 percent, there were some who were thinking that we had to do something with the discount rate to have a workable relationship. But with the passage of time and with some comments that had been picked up by the market, I think they became reconciled to the reality that it does seem to be a workable arrangement.

MR. KOHN. But, as Peter remarked in his briefing, it's not just a technical thing. Part of the reaction in the markets was [because] we didn't lower the discount rate and it looked like we weren't intending to do anything again very soon. So, I don't think I agree entirely with Peter's answer that if we did lower it, the market's reaction would be entirely neutral. It would be seen as giving a scope for further easing much as when the Germans raised their [Lombard] rate and made a very loud noise about how it wasn't going to affect their overnight rate and everyone assumed it was going to affect the overnight rate eventually anyhow. It's very hard to change [the discount rate] when the spread had been zero, [and have] a neutral effect at this point.

MR. SYRON. There's a quite ambiguous statement in the Bluebook about a change in the funds rate having--I can't recall the exact words--a pronounced and pretty short-term impact on the exchange rate of the dollar, etc. What's the parallelism between that and the discount rate?

MR. KOHN. Without it showing through or with it showing through?

MR. SYRON. Without it showing through.

MR. KOHN. I think it would have much less of an impact on the dollar than if an actual cut in the funds rate had accompanied it.

CHAIRMAN GREENSPAN. Any further questions? If not, would somebody like to ratify the actions of the Desk since our last meeting?

SPEAKER(?). So move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objections. Mike Prell.

MR. PRELL. [Statement--see Appendix.]

MR. SIEGMAN. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Thank you. I think we ought to take questions for these gentlemen and then break for coffee. The floor is open.

SPEAKER(?). The thought of coffee killed any questions!

CHAIRMAN GREENSPAN. Well, let's break for coffee.

[Coffee break]

MR. FORRESTAL. Let me start with the District, if I may. We're getting very mixed reports on the Sixth District. Considerably more optimism has developed, as one would expect, after the ending of hostilities in the Persian Gulf. Realtors are reporting that sales of single-family homes picked up in February and that inquiries and traffic have been quite strong so far this month. In fact, I spoke to one of the leading realtors in Atlanta and he told me that February was one of the best months they've had in a long time. That may be seasonal, of course, but the contacts that I've been talking to seem more optimistic about their prospects as long as mortgage rates don't back up much further. On the commercial side, because we've had so much overbuilding and because in-migration of businesses and individuals is at a much lower pace than just a few years ago, I think construction is likely to remain weak for some time to come. Reports from retailers indicate sales levels that are below those of a year ago in real terms and there's a great deal of caution about inventories. Most retailers are trying to prevent inventories from rising or are trying to reduce them through aggressive promotion. Trade show contacts report that orders for giftware are strong and orders for apparel and other consumer items are quite soft. Auto dealers think that the worst in sales may be over and they expect a modest pickup in the months ahead.

On the manufacturing side, the attitudes of manufacturers in the District are really quite negative at this point. Some exports are doing reasonably well but that has had little impact in the District since the region's tradable goods sector is relatively small compared to that of the rest of the country. Export growth in the pulp, paper, and chemical industries slowed over the winter and the chemical industry in particular had been a source of stimulus and strength before. This is due primarily, we understand, to concerns over the war and may prove to be temporary, although we haven't heard of any renewed strength so far. Convention business also weakened during the winter and reports in early March suggested no improvement in Atlanta and New Orleans where bookings are running below those of last year. There is concern that pressures to cut corporate travel budgets will sustain the weakness. On the other hand, contacts in Florida, and particularly in Orlando, tell us that the number of foreign visitors has picked up since the end of hostilities. The oil production and exploration areas were not affected very much by the conflict in the Gulf. In February the average rig count in Louisiana was up just 3 percent from a year earlier. Permits were also up a little. And the area is still suffering from a shortage of skilled labor; that situation has not improved.

Reports on credit conditions suggest little easing of the tighter standards imposed by banks, although on the supply side banks are telling me that they are out in the marketplace seeking loans. But most lending officers are almost totally unwilling to look at any kind of real estate related loans. We had a group of high-tech people in a week or so ago, and while they all report that they're looking for an expansion in export sales, they are complaining bitterly on their own behalf and on behalf of their customers about the difficulties that they face in obtaining financing. On the wage and price side, our directors are reporting very, very little pressure in either of those areas. I would also just add with respect to the District that our unemployment rate went up to 6.9 percent, which is higher, of course, than the national average.

Looking at the national economy, our forecast has been revised lower since we met last time. The larger decline that we had expected in the first quarter is not fully made up over the rest of the year after the economy turns around. In comparison to the Greenbook we don't see the expansion as being quite as strong over the remainder of the forecast horizon. We think the rise in consumption is going to proceed at a somewhat slower pace than the staff forecast, and I think demographic factors account for a good deal of this. Our outlook for prices is basically different from the Greenbook. We have the CPI rising at a slower pace in 1991, and we don't get any improvement as time goes on. In fact, the pace of the CPI deteriorates a bit in our forecast. We are similar to the Greenbook, however, in that we do show a resumption of growth sometime during the second quarter, certainly in the second half of the year. And while I'm a little more comfortable with that forecast than I was six weeks ago, I remain concerned about how much fragility there is in the economy. We've had declines in asset prices and we have high debt levels; and the continued emphasis on problems with deposit insurance threatens to erode confidence somewhat. The recent rise in confidence --certainly the number [released] this morning--is encouraging but I have to wonder how much of it has to do with the euphoria over our success in the Persian Gulf; I haven't yet seen it translated into any hard spending and that may not occur. In addition, as was mentioned early this morning, I'm concerned also about our estimates of activity for our G-10 partners. Those estimates are being revised lower, as we heard, and it seems as if we're now dependent on activity strengthening abroad as well as here in the second half. Even though there's some offset from reconstruction demand in Kuwait, this may take more time to develop and it does reflect a need for capital.

So, in summary, Mr. Chairman, I believe that these forecasts of an impending turnaround have a fairly high probability of being right, but I'm concerned still that the risks to the outlook are on the down side.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, we've moved in a slightly different direction from Bob Forrestal in that we think the near-term outlook has improved significantly since the February meeting. Back then we were expecting the recession to last through most, if not all, of the second quarter, and we felt that the risk of error in the Board staff's projection was clearly on the down side. We now agree with the staff that the economy is likely to turn back up in the second quarter and we think the bulk of the risk has now shifted to the up side, particularly in the second and third quarters, although obviously there is still some risk that we could have more down side weakness than we see. For example, exports might not do as well as we are thinking.

The main reasons why we feel a little more bullish are what you might expect. One has been this decidedly improved level of confidence on the part of businesses and consumers that followed the ending of the war. The second is that we've had this flurry of scattered statistics that suggest some little intensification of activity. And the third is that the grass roots information that we're picking up around our District is decidedly better than what we saw at the time of our last meeting. And the improvement appears to be more than what could be accounted for by the normal seasonal things, which is something that businessmen have difficulty distinguishing when they're reporting on whether business conditions have improved. For example, at our last board meeting I saw what was the most abrupt change in the attitude of our directors between two meetings that I've seen at any time since I've been with the System. They were practically all on the positive side. The one exception was our director who had been on the positive side before and he has moved to the negative side now. But seems to move in a different direction from everybody else on a lot of issues. And then the last but by no means the least reason we're more optimistic is the pickup in growth of M2. It seems to be responding to our earlier easing actions and, as Mike Prell indicated, that doesn't guarantee a strong recovery but it certainly does enhance the possibility that that is what we'll get.

On the price side, we were particularly glad to see that the staff has lowered its forecast of inflation somewhat over the period ahead. We're still generally optimistic that long-term inflationary pressures are going to move in the right direction as a result of what I think has been a very wise monetary policy over a period of several years now. I think we're going to hit pay dirt on that one. But I am disturbed, of course, by the rapid run-up in both the consumer price index and the producer price index even after allowing for the known special factors. I'd be even more concerned about that if the recent growth in the aggregates doesn't slow somewhat in the near future from its pace in the last couple of months.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, the Twelfth District economy has shown some signs of strengthening in recent months. The California economy, which contracted in terms of employment between July and December, is showing some positive signs. Although the California unemployment rate rose markedly in February, that largely reflected a sharp increase in the labor force. Payroll employment growth actually was up strongly in January and flat in February. Moreover, anecdotal evidence suggests that the residential real estate market is beginning to recover in the coastal California cities. And recent rains have raised reservoir levels to a point where some of the more drastic rationing plans are now being softened. The rest of the District appears to have avoided any significant downturn. All Twelfth District states have higher employment growth rates than the national average and most did not experience much of the slowdown [seen elsewhere] following the onset of the Persian Gulf crisis. Annualized payroll employment growth rates between July and January outside of California ranged from 2 percent in Arizona to 6-1/2 percent in Nevada. Increased real estate activity is also reported in Seattle. Other real estate markets, which were not as adversely impacted last fall, remain stable. The relative strength in the West is reflected in its commercial bank lending. Although loan growth has slowed, loan volumes continue to rise. Total loans at the District's largest banks rose 7 percent in February over a year ago compared to only 1.2 percent for the rest of the nation. District bank real estate lending accounted for much of the fast growth, increasing 10.4 percent over the level a year earlier. Admittedly, some of this was a result of changing shares as the commercial banks successfully competed against the savings and loans in the District.

Turning to the national outlook, we expect a short recession and moderate recovery especially now that the war in the Gulf is over and oil prices have remained low. Specifically, we anticipate an economy much like the Greenbook forecast with output declining at a rate of about 2 to 3 percent in the current quarter and recovery, we would expect, before midyear. The sectors that have contributed most to the fall-off in final sales, namely consumer spending and also residential investment, should contribute the most to the recovery in final sales. Retail sales and housing starts reports for February and the upsurge in consumer confidence in early March are certainly consistent with this kind of outlook. Because the recovery in our view is likely to be moderate by historical standards, we expect the unemployment rate to stay in the 6-1/2 to 7 percent range this year and then to decline gradually in 1992. Temporary slack in the economy should produce a moderate decline in the inflation rate between this year and next, as in the Greenbook forecast. But we also expect that an increase in the fed funds rate will be required later this year to keep inflation on a flat to declining path. Thank you.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I sense something of a dichotomy in the District with the end of hostilities and the arrival of spring, which in Chicago is always a welcome event, or the combination of the two. I think attitudes in the District are quite significantly better than they were at the time of the last meeting. Retailers, for example, are reporting a significant increase in floor traffic and, in turn, improvement in sales of small ticket items. It hasn't yet flowed through to big ticket items, but small ticket items are up.

Auto dealers certainly have a significantly improved attitude. As they went through December, January, and February--a very grim period--dealers were ordering cars from manufacturers at rates lower than the retail sales level. That has now reversed; they are ordering cars at a higher level than their retail sales. And while that's typical for this time of the year, nonetheless, I think it is a decided shift in attitudes. But while the attitudes seem better, some of the specific numbers really don't line up with these improved attitudes. The District labor markets, for example, are weak. And while our numbers had compared favorably with the national numbers, we're seeing some deterioration there. Claims for unemployment insurance are rising in the District, and my hunch is that our numbers are going to begin to take on an adverse comparison with the national average. We're continuing to experience what I think of as an unending series of layoffs from one plant to another--100 people here, 200 there, etc. Specifically, in the auto industry, though the outlook may be improving, it's at pretty grim levels. The manufacturers that we talk with have reduced their sales forecast for the full year again, down to 13 million units; of course, that's cars and light trucks. And even that number is dependent on comparatively good third and fourth quarters. The production levels in the auto industry in the second quarter will be higher than the first quarter but still some 10 to 15 percent lower than last year. And as I hear it, the production risk in the auto industry is still very much on the down side at this point.

This weaker auto situation is reflecting itself in the steel industry. That industry is reducing its forecast for shipments for this year down to 77 million tons, which is down from 80 million tons at the time of the last meeting and down from 85 million tons for last year. One manufacturer, at least when I talked to him, was producing at 70 percent of capacity. The order rate is a little higher, so they won't do poorly in inventory. Prices in the steel industry are at best stable but at a very low level. The competitive conditions there are really very, very tough and as a consequence some have gone through some difficult profitability issues. The pricing in general in the District, as far as steel and other things, is reflective of that. Competitive conditions are awfully tough and for most items I don't sense much upward pressure. In heavy trucks, i.e. Class E trucks, a category I haven't talked much about, conditions are really very weak. Sales and production this year are off some 25 percent from last year; last year itself really was not a good year. And one major engine manufacturer, a supplier to that heavy truck industry, is currently running at 30 percent of capacity, so they are really all but shut down and they don't expect any near-term improvement. In fact, normally they sell about 180,000 units in a reasonably good year and the sales forecast for this year is between 110,000 and 130,000 units; therefore, it's a pretty depressed situation. Adding to that problem for that industry, some of the major haulers are having a tough time getting credit to finance the purchase of equipment, so that just exacerbates the problem.

The machine tool industry is a bit brighter than some of the other industries in the District. Sales and backlogs are a little higher. The auto industry will have to go through some significant model changeovers in the next couple of years, and that shows up in improved orders for machine tools. Net, in the District context, I hope that we are going through something of a transitional phase and that we will see some improvement in the numbers following this improvement of attitudes that I certainly feel.

In a national context, we have no basic disagreement with the staff forecast, at least in pattern. We think we are moving past the low point here. But our expectation is that the recovery will be a bit more modest than the staff forecast would suggest, at least for the next couple of quarters. The personal consumption numbers look a little high, particularly for durables; that in turn will be dependent a great deal on the auto industry, and we'll just have to see how that works out. So, as we look at it, we think we are moving through this transitional period, but at least for the moment the risk continues to be a bit on the down side.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mr. Chairman, considering the meterological analogy, spring hasn't come to New England yet either in terms of the economy or the weather; it was snowing when we left there yesterday. One would be hard pressed to call our situation "mixed." I think on balance it's still pretty negative. There are a few glimmers of hope; there is some fairly significant improvement in the sales of existing homes, consistent with what is happening nationally. That might be expected, given that the prices probably have fallen about 20 to 25 percent. We did a survey of auto dealers in the last couple of days to find out what is going on. Some hope is being generated with increased foot traffic but not sales as of this point yet. Actually, dealers did not believe that they would get [increased] sales this quickly after the foot traffic went up. In manufacturing, the only strong point that we have--and I might be stretching to call it strong--is that exports are still holding up. But even the defense goods producers are having layoffs.

The most hopeful sign may be that we're getting price and wage adjustments. Actually some work we've done on that indicates that at least for New England historically we really have to have a period of substantial declines in employment and substantial increases in unemployment before we reach a threshold--and that's in both directions--that affects wage behavior. We now have had for the region an employment decline, since the local peak, of somewhat greater than 6 percent, which makes it the weakest period of decline in New England on a peak to not-yet-trough basis in history. It's possible, but we don't have the monthly data, that in 1946 when a lot of the shipbuilding facilities closed after the war we might have had as much of an employment decline, but that's how far back one has to go.

All of this, of course, has had a negative effect on consumer confidence; it is flattening a little but is still very low. Retailers report very soft activity with a lot more discounting going on. In construction--and this is something that needed to happen--the value of what is being put in place is down somewhat more than 50 percent. Financial sector problems are still prominent in the news. We expect that in addition to the Bank of New England situation we'll have another $20 billion in institutions this year that will have to be resolved. That will be a total roughly the size of the Bank of New England and will be a further hit on consumer confidence. As far as the credit crunch goes, I don't think there's a great deal of improvement with our own indigenous institutions. We are seeing more entry of nonbank financial institutions and others coming into this market to pick up some opportunities that may be there.

An interesting note is the fiscal problems of our state and local governments. If you look at either the reductions in expenditures that are going to be required or the likely tax increases, it comes out District-wide as a number somewhere on the order of 2-1/4 percent of personal income. And if you add local governments to that it goes to about 2-3/4 to 3 percent. So, we think this is something that is going to be rolling through toward the end of this year that will have a further effect on consumption. We do think that the region will at least flatten about two quarters after the national economy.

As far as that goes, I find the Greenbook conditional forecast for the next several quarters pretty persuasive. The only place I may question it at all is on the basis of [the inadequate] weight it gives to state and local government [spending], which the Greenbook already has as being pretty soft. But looking across the nation I'm not sure what is going to happen with that sector. I do think, as it should be, that the risks implied in the Greenbook forecast are pretty symmetrical both on the up side and the down side.

As far as policy goes, we've done a fair bit already and there are some lags involved; and Mike referred to some of the early signs one might see of upcoming improvement. An important factor for us to keep in mind at least--I don't want to preach about it--is that the recession wasn't caused strictly by Iraq in my view. We also had adjustments to some fundamental imbalances in the economy that were of a balance sheet nature in some cases. I think New England was an extreme case of that, depending on some of the activity that had gone on there and that had gotten a little out of hand. And in this environment I think our responsibility is to provide a climate in which these imbalances can be addressed in a painful adjustment period but over time. Again, I think the Greenbook forecast is one that would allow us to do that and, obviously, in periods such as this one should be cautious.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Springtime has come to the Eleventh District, and I have a good bit of it in my sinuses right now, as you can tell! At the last meeting I reported that economic activity in the Eleventh District was either stronger or less weak than in the nation. That continues to be the case, and perhaps even more so. One measure is total employment, and employment is continuing to increase in all three states of the District and in most major sectors of the economy. It is slow growth but it is growth. Anecdotal information from directors and other community people we've talked to does not sound quite as positive as the numbers seem to look. They emphasize the fact that the economy is not so strong that it can stand up against the national recession, but they also emphasize continuing credit availability problems. The reluctance of banks to lend is cited by all of our people out there as the key factor that they believe is going to keep the recovery fairly mild. But one of the members of our Small Business and Agriculture Advisory Committee a few weeks ago reported that if you went into a bank four years ago and asked for a loan the answer was "Hell no!" and if you do it now the answer is merely "No."

Given that circumstances in our area are more favorable than they are in most of the country, we don't find the Greenbook forecast to be implausible. We think it's pretty much on the mark, although we probably would push the recovery from the second to the third quarter and would not be quite as optimistic about the abrupt decline in the consumer price index as the Greenbook forecast.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. The District economy is still declining, but there are some straws in the wind that a recovery may be in the making. There has been a shift in attitudes toward the positive side.

Even in a state like New Jersey, which has some of the characteristics of New England, I think they are beginning to feel better. And I had the same experience with my board as Bob Black did with his. I really don't recall such a dramatic shift in attitudes on the part of nine people over a one-month span. There are a few signs at banks that loan demand may be picking up. Bankers are not as willing as they once were but there is willingness to lend; but these are more at the "nibble" level rather than anything very major. Home buying has clearly picked up and the real estate people are--euphoric is too strong, but they are feeling very good. That has not spilled over into automobiles, although there is more traffic at dealerships. Nonetheless, when you look at the hard numbers, sales are still down. The retailers, particularly department store people, say that sales haven't picked up except that right after the end of hostilities there was a pickup for a week or so; but they haven't seen it more recently. Now, some of the specialty stores report that business has picked up. Manufacturers, while they are hopeful about the second half of the year, say their numbers are still bearish; and the people who transport manufactured goods report business is still bad. As for the commercial real estate market, I think we're not talking months but several years to get that turned around in the middle Atlantic states. So, I would say, with the exception of what is going on in home sales, that the recovery is mostly hope and attitude at this point. But that's an important change and is probably a harbinger of things to come.

My judgment on the national economy is that the risks are in the process of shifting from a decidedly downward direction toward a more evenly balanced outlook for the economy. And I think that we ought to pay attention to that shift as we move into the policy discussion later this morning.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. In our District I would agree with something Ed has said. So far there is little that one can really put a finger on statistically; it's more of an attitude change that I've noticed. I had the same experience that Ed and Bob described with our directors about a week ago; there was a very noticeable shift in sentiment. Statistically, I guess the one thing we can hang our hat on is employment growth. It had gotten very sluggish; it never had turned negative in the District on a year-to-year basis, but there is some evidence that it has bottomed out and started moving up. And that's a combination of both less weakness in the manufacturing area than nationally and considerably more strength in the non-manufacturing area. The other piece of evidence we have is not so much in terms of the current economy but we have year-end numbers on banking; bank performance has continued to hold up with [delinquencies] of about 0.9 percent and not a significant increase in either loan losses or nonperforming loans. We're perhaps a little behind the rest of the nation in potential real estate problems, but I don't think those are going to get significantly bad; we never had the boom, really.

Nationally, the only comment I would make is that I'm pleased to see that we can now look back and say that we have had some sustained growth in reserves and money. And at least for my part, I'm not too concerned about reacting to that at this stage. There would come a point in time when maybe I would, but things are tenuous enough now that I'm just pleased to see it and leave it at that.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, looking first to the national economy, the forecast of the staff in New York in profile terms is similar to Mike's but there are a couple of differences. Our staff essentially has the second quarter as flat and a more modest recovery in the third and fourth quarters. But for what it's worth, the 1992 outlook is very similar to Mike's forecast with one or two exceptions that aren't important except in terms of algebraic signs. We have net exports turning into a drag in 1992, and I want to come back to that in a minute. And we also have slightly less improvement in core inflation in 1992. Mike, you have it getting down to around 3-1/2 percent?

MR. PRELL. Well, by the end of the year.

VICE CHAIRMAN CORRIGAN. We're basically in a holding pattern at 4 percent, which isn't great given all we've been through. In terms of even the profile of the forecast, the one substantive thing that I am a bit more concerned about--aside from some anecdotal reports, which I'll get to in a minute--is the external side. The kind of forecast we're looking at for 1991 even in the context of something like the current pattern of exchange rates I don't think is unreasonable, but I think there is greater risk--and Bob Forrestal or somebody already said this--on the foreign growth side, looking out from where we are right now. And given the tenuous nature of the outlook, that situation at the margin can make a difference. Nevertheless, I think the case for a modest recovery sometime in the spring or early summer is not at all unreasonable at this juncture.

In terms of anecdotal reports, we're hearing things not unlike a number of things others have said. For example, there is widespread gossip, if I can put it in the proper terminology, about a pickup in activity in housing. And that's pretty much true at big banks and small banks, upstate and Long Island; it is not true in the very expensive New York City condominium market. But with that exception there does seem to be something more than a seasonal pickup in housing. The retail sector is still soft, and manufacturing--at least as we hear about it from the vantage point of very large manufacturing firms that are headquartered in New York--is still very soft. The credit situation is better. We do get anecdotal reports--and somebody else said this, too--that at least some banks are actually out there looking for loans so long as they're not real estate loans. Again, there are sound straws in the wind that the asset price deterioration may be beginning at least to moderate, if not to flatten out. It's probably a little too early to make that judgment in any definitive way, but it seems to be a bit better. Having said that, there is something else that seems quite clear, and that is that people feel better. I guess there's a bit of a similarity with where we were last spring. If you recall, last spring the anecdotal reports and the expectations were lousy and the numbers were still pretty good. Right now we seem to have a situation in which the expectations and anecdotal reports are pretty good and the numbers are still pretty lousy. I blow a little hot and cold as to what to make of that. I think there is a danger that if the postwar euphoria does not in fact reflect itself in some pickup in spending and activity, this rebound in confidence could reverse very, very quickly. It's awfully hard to judge that, but right now the comment that a number of people here have made to the effect that people seem to feel better certainly is the impression I'm getting, even though the numbers aren't there to support it at the moment.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Well, with regard to the District economy, I think we are basically beset by the same crosscurrents that are affecting the nation and that many people have discussed. The market and the economy remain quite soft but the anecdotal information clearly has a much better tone encompassing housing and autos and retail activity; people at least are feeling a good deal better and traffic is up. In part because of the improvement in attitudes and the change of the tenor of the anecdotes, I am comfortable with the Greenbook forecast for real activity this time. And it is also this time very consistent with the pattern that our model produces, and our model is very different in structure. That does raise an interesting timing question, though. Even if the economy picks up promptly in April--or maybe it already has picked up--we won't see that in the hard data on aggregate activity until May or June as those numbers start to flow through. Given that we obviously would want to see some consistent evidence of improvement, it really suggests that it won't be until sometime this summer that we will recognize whether or not the Greenbook forecast is turning out to be accurate. I don't know what the implication of that is except that it seems to me that we might want to be even more cautious than usual in terms of responding to information as it becomes available over the next month or two.

On inflation, obviously, we were concerned too about what looked like a significant acceleration of core inflation; and I'm always a little suspicious about special one-time factors that one can parcel it out to. But we did run some tests to try to find out about the energy prices, assuming that the run-up in energy prices in the summer and fall may have boosted core inflation temporarily as they worked their way through the economy. The tests suggested that that was in fact the case.

CHAIRMAN GREENSPAN. Does Mike Prell get the same number?

MR. STERN. Yes. And as the subsequent decline in energy prices starts to work its way back through, it seems to me we ought to be looking at better core inflation numbers rather promptly.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Mr. Chairman, in the Tenth District, the economy continues to outperform the national economy modestly and that is a bit of a departure from the long-term trend; we normally lag the [national] economy. But both the personal income as well as the employment numbers show that the economy during the fourth quarter continued to add jobs and that that will continue in the first quarter. The District added jobs at an annual rate of about 1-1/2 percent during the fourth quarter as the recession took over nationally and, as I understand it, the national employment figures dropped about 1.6 percent. So, in terms of the overall health of the

Tenth District relative to the nation, I think we're still doing fairly well but at a very slow pace. There were jobs added in each of our seven states with the exception of Oklahoma. Overall, the region in terms of economic health is being held down a little in the manufacturing sector because of our area of Missouri.

It is, however, a time when the sap begins to rise and the euphoria comes on the agricultural sector. In agriculture, cattle and hogs, the red meats, are still the most important addition to the economy in the sense that feeder cattle, for example, are now selling for over $100 per 100 pounds, which is an all-time high. On the other hand, small grain, and principally wheat, does have some serious problems because of the drought. Governor Angell's farm probably ended up partially in Oklahoma City a couple of weeks ago when there was a big dust storm coming out of western Kansas and western Oklahoma! If that area continues without moisture, clearly, the outlook for wheat will be hurt. With regard to manufacturing, perhaps the story has been told many times with regard to auto assembly. Clearly, each of the assembly plants in our District is cutting back; they actually are cutting out shifts and/or closing down for short periods of time. I do understand, however, that the inventory of cars being held now by the manufacturer and the dealer is coming down to a very low level. If there is a pickup in consumer confidence, that should be a real kick in terms of the manufacturers coming back on stream. The energy area is essentially flat; there hasn't been much activity. Drilling activity had actually decreased month-over-month, but that is so small that it makes very little difference probably. The one area that may be a catalyst, or an area of the economy that could give a kick start to the Tenth District, would be oil field construction and drilling equipment orders that may come as a result of the Kuwait/Iraq situation. We do have several rather large oil drilling construction companies in the District.

As far as the national economy is concerned, I would agree with those who say that the second quarter probably will be flat and the third and fourth quarters will be a little less vigorous than the Greenbook forecast. But overall the Greenbook is about as good a guess as I have or as most everybody else has, I think. I'd be willing to buy it.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I didn't intend to follow right after Roger's comments about the wind. It is true that the high plains do see heavy winds in March, but we always seem to gain soil rather than lose it.

CHAIRMAN GREENSPAN. I don't know. Would you get it from North Dakota?

MR. ANGELL. It seems to me that the staff's forecast is plausible. But if I [differ] in any direction on the forecast, it is not so much in regard to the timing but that I lean toward a bit weaker view of households' penchant for consumption expenditures. My hunch is that this recession has been different from others in regard to the [buildup] of debt and that the saving rate will tend to run a little higher in this recovery period. I am slightly more optimistic in regard to net exports--although I know the staff is also optimistic--but maybe not quite enough to offset the difference of somewhat flatter consumption expenditures, if there is any difference. It just seems to me that this event, even at the manufacturing level or the business level, is going to be one in which recovery in spending may occur prior to that in unemployment. So, I would expect the unemployment rate to continue to move up and maybe to approach 7 percent, even though we have this kind of expansion. The talk about medical costs just has to be quite a factor. [Unintelligible] union collective bargaining power in terms of the desire [of business firms] to maintain somewhat leaner labor costs. So, I would expect it to be in the direction that the staff has but just slightly less than that, as I judge it.

It does seem to me that the pickup in M2 growth is coinciding with some flattening of the commodity price deterioration. And the commodity prices don't look exactly the way they sometimes look in a full-fledged recovery--that is, if a full-fledged recovery were underway right now. But at the same time commodity prices certainly are not deteriorating the way they were as we were going into recession. So, it looks to me as if we're close together in regard to the outlook, but maybe with a somewhat longer and less robust recovery path.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. The District's goods manufacturing is pretty much deteriorating. And for the first time we have in Ohio an unemployment rate that is higher than the national average. I rather wish that Martha were here to hear that because she has been saying all along that our region has been a lot stronger. It's about the same in Pennsylvania; it has deteriorated a bit there as well. And it's in the usual suspects--autos and steel; Si has already mentioned steel. We are seeing some bounceback, though, in activity in department stores and in home mortgages. So, the signs the rest of you are picking up, we're picking up as well. The only anecdotal story I want to share with you, because it was a little surprising to me, relates to my specialty steel producer
I called him up before I came down here and asked about his order book. It has been very weak, as steel was weak throughout the fall and the first quarter. He started out very cautiously in saying that they were going to make it through the year and it will be fine. And then I pushed him a little and he said that the export side of his business is very strong; he has booked in the first quarter more than he booked all last year on the export side. Now, his concern as we went down this path a little--and I found this to be an unusual one--is that his people can book him out through the third quarter but if he goes ahead and does that on the export side and we get a snapback in the economy, he won't be able to service his local customers. So, he's almost in the position now of thinking about not booking the export side of the business. He can't turn the orders away, obviously, but that was one unusual story that I heard. I don't know if it's typical or atypical.

In terms of the national economy, as I look at the Greenbook and what we went through in the last six months around here, it just reminds me that, at least the way I look at it, we don't control much on the real side. A lot of other things happen; Dick has mentioned a couple and other people have too. So, I don't think we should view ourselves as managing this recovery any more than we managed the downturn. What we control over time is obviously the price level, and we put ourselves in pretty good stead to continue to do that if we continue to watch the aggregates. I'll save those comments for later.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Well, we are in an interesting period and I have a few observations on the issues. The first question is inflation and our fears: Are there fears that inflation is reigniting and is it reigniting? I think the economic logic is clear and supports the opposite case, given the increasing slack we have; I see no signs of trouble in the commodity prices or movement in the dollar. Despite the recent revival of M2 growth, we're coming off a long period of slow growth; in seven out of the past ten months, M2 growth has been less than 3 percent. The labor costs data, one of the toughest components of inflation, is behaving remarkably well. And even the inflationary expectations in the surveys are down somewhat. So, I think everyone should agree that we're making substantial progress on inflation. The only thing that doesn't agree with that is measured inflation itself, which keeps chugging along apparently oblivious to the inescapable economic logic. We've had a couple of pretty awful months and there are stories especially about the postal rates and the excise taxes and the like. Many people would argue, especially for those special cases, that government-induced increases are not part of the inflationary process. But the problem is that they are. They respond in part to the increases in labor costs and they also feed into the inflationary process. So, I think it's a little difficult to ignore.

The markets may also be getting concerned about inflation. Long bond rates are up about 35 basis points since the last meeting. Our Board staff argues that that is an increase in real rates rather than an inflation premium, and they point to a broad array of market data consistent with that analysis, including the stock market data, the junk bond data, the dollar, and commodity prices. And everything is suggesting increased probabilities of an imminent turnaround. Even on March 19th, when the CPI number was released, the housing starts data were released the same day and the dollar went up, which is rather inconsistent with a lot of fears of inflation. Some people believe another reason the long rate went up was not only because of the notion of a turnaround but also because the CPI numbers might keep us from easing. Peter has already talked about the bond market's reaction to our 1/4 point ease a couple of Fridays ago, March 8th. In those three stories I think there is a fair amount of confusion: Some people said that maybe we had gone too far, but at least as many people seemed to say the fact that we cut the fed funds rate and didn't cut the discount rate signaled that this was the end of the easing. When I talk to people on the street, there's still a fair amount of confusion over exactly what signal we're trying to send with the fed funds rate on top of the discount rate even though operationally it may work okay. I think the most compelling thing that happened that day, though, was that the Michigan survey leaped with a 20 or 30 percentage point increase. So, it's difficult to make much out of that, and I'm comforted by all the market data that say inflation is under control. To me the most troubling aspect is to look back for seven years to the beginning of 1984 and see that core inflation has been stuck at between 4-1/2 and 5 percent, which makes one wonder whether a short and shallow recession can really do the job. The logic is pretty persuasive but one thing we're going to have to face, if we get a string of these, is that the bond market itself will stop buying the story and start looking at the numbers. I'm sure we're all prepared for that.

In terms of the real economy, again, everything looks great: The war is over; oil prices are low; consumer confidence is back; money is growing; and all markets are signaling a rebound. To turn this logic into reality, we need consumers willing to spend and bankers willing to lend. I share some of the opinions expressed by others that while we're seeing confidence go up, there's a question of whether it will stick and an even greater question of what sort of lag there is between that confidence and the actual spending. On the down side, when confidence collapsed in August, it was really a couple of months before spending collapsed. I doubt if it will be much faster on this side of the hill. Moreover, this is the first national recession we've had in eight years. Many young working Americans have never had the experience of worrying about their job security and I wouldn't be surprised, as Governor Angell also indicated, if consumers much like banks and corporations don't step back and spend some time building some equity before returning to their old ways. And it is true we have some drags on the process, including the unemployment situation. I would also agree with Dick Syron about the state and local government situation; when you look across the country, by some measures 28 of 50 states have pretty severe problems. That's likely to be an overhang. In terms of hard data, one thing is clear: Americans did not celebrate victory by buying a new car.

In terms of the hard data, we are staring to get some uptick. Clearly, the most encouraging area is housing. Even the February data in housing, of course, could be the effect of global warming because we did have a warm February and that's the most highly correlated thing with housing starts and, I guess, existing home purchases. I see one potential problem, though, with a housing-led recovery. And that's this question of whether the banks will finance homebuilders, because I don't think there's anyone else around to do it. Not many builders have access to the commercial paper market. I don't see insurance companies or finance companies financing construction. And, I submit, we'll find out whether we have a credit crunch or not--whether it's on the demand side or a supply constraint. With the commercial real estate disaster fresh in their minds and with many builders financially weak or bankrupt, capital-thin bankers are going to be asked to finance a new round of real estate development. And, again, the logic looks pretty encouraging as well. The banks are in much better shape now and we've seen them raising capital. They haven't been lending so much yet; but if we expect homebuilding to play a major role, pretty soon we will be going through existing inventories and we will see whether they can get that financing.

One important piece of evidence that many people have mentioned, which is consistent with a return to more normal conditions in the banking industry, is the growth of the monetary aggregates. It looks as if we finally have the engine of money growth jump-started. It may be idling at a rate that is a little high and we may need to adjust the choke a bit. After ten months of slow growth, it's encouraging to see the pickup, but there is a question of whether it's going a little too well.

There is another factor that weighs on the other side of the growth in the aggregates and that's the behavior of the dollar. As mentioned, since the last meeting the dollar on a trade-weighted basis has essentially retraced all the ground that it lost during the war. It stands about where it was the middle of last summer, though still down from its heights of last spring. I view the increase in the dollar as something that should have a contractionary effect; it should weigh against inflationary pressures and should reduce the risks of an overly robust economic rebound. In other countries people view a strong currency as equivalent to monetary tightening. Indeed, Charlie Siegman mentioned that, in effect, it is equivalent to an increase in interest rates or that to offset it we would have to reduce rates. So, my view of the increase in the dollar is that we have the opposite of the situation in August, September, and October when interest rates were steady and rising and the dollar was falling, which helped cushion the decline in the economy. I think we are now in the opposite situation where the dollar can be viewed as a partial counterbalance to concerns about too rapid growth in the aggregates, a rekindling of inflation, and a rebound that is too buoyant. The Greenbook assumes the dollar will fall back from its 11 or 12 percent appreciation to a 4 or 5 percent gain; I guess I'm not so sure. When I look at the position of the U.S. economy and political system coming out of this war and when I look at the troubles in Germany, eastern Europe, and Russia, with the rest of Europe wired together through the exchange rate mechanism, and the prospect of lower growth and lower interest rates in Japan, just the uncertainty in these areas versus the situation in the United States makes it not unlikely that the dollar will maintain its gains and might appreciate a bit more. And I view that as a risk to the upturn and as insurance against inflation.

So, in summary, I'm pretty much about where Governor Angell is. On balance, I'm a bit more pessimistic than the Greenbook on the timing and strength of the rebound due to the strength of the dollar and the lag in the transformation of consumer confidence into consumer spending as well as a couple of other overhanging risks such as the financing of the housing side and the state and local government side. I can't be too pessimistic since I've spent most of my career as a financial economist and I believe in markets. And the staff has pointed out to me that every market indicator known to man, woman, or beast is flashing a clear signal of imminent economic rebound. I didn't quite see those signals on the other side when the economy started down, but at least that should temper our pessimism.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Well, like everyone around the table, I guess, I have some sense of encouragement that we are hearing some good news. Certainly, the return of consumer confidence has some promise. The decline in oil prices and the projected level of oil prices has to be good for economic activity. The slight uptick in retail sales is encouraging, but I have a little skepticism about it; this confidence may be enough to get people smiling and walking to the mall, but whether it has them reaching deep into their pockets for the big ticket items is another question. The housing starts look better but we're still a long way from what anyone would describe as an ebullient housing market. Sales of existing homes are probably one of the brightest lights and really give some glimmer of hope, even up in darkest New England. On the other hand, auto sales, which are such an important part of the economy, are still absolutely lousy. I think that industry is considerably worried because we see all these leasing opportunities as an inducement to try to get people to do something without having to commit a lot of money up front. I'm skeptical of what I've heard, at least spottily around the table, about business confidence. I don't see the signs of business confidence; business profits are lousy. And I think that has contributed to the fact that there is not widespread significant credit demand from the business sector. In fact, we see businesses restructuring--not restructuring in the '80s style of piling on a lot of debt but rather restructuring in terms of selling assets to pay down debt, cutting expenses, laying off people, and shutting down plants. And that's not exactly the kind of environment in which one expects an immediate return of a high level of business activity. The very high levels of debt of both businesses and consumers are a further deterrent, particularly if people are concerned about unemployment and the possibility of being laid off. All of this coupled with the remaining unsettled conditions in the banks raises some questions. I think confidence is being significantly undermined by the FDIC floundering around trying to figure out how to refinance itself--and with no clear public policy direction coming from any part of the government with regard to how to do that plus the fact that there is a possibility that the inability to deal with this effectively will result in a "taxpayer bailout," which will effectively scuttle the opportunity for restructuring the banking system and modernizing it. All of that is creating some lack of public confidence not only in the banking system but in the deposit insurance system.

Then add to that something that Governor Mullins touched on, which is that the upturn in long-term rates is more likely to be a reflection of higher inflationary expectations, and that kind of environment especially is not going to be a contributor to recovery. So, I believe the downside risks remain very significant. But I am also skeptical in that interest rates and interest rate adjustments may not be the effective medicine if the problems that are inherent in this economy are more psychological than financial or rational. So, I'm at the point where I think it is much too early to take the punch bowl away; but at the same time I wouldn't be inclined to refill it.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Well, Mr. Chairman, once again I'm the last leaf on the bush and the day is getting long, so let me be brief. As I contemplate this recovery, I'm mentally migrating West; I'm going to be from Missouri for a while! We do clearly see very positive sentiment, but there are just no data as yet to support it. And I think Gary's point earlier is worth repeating: We have to be careful about this confidence business because at some point if it doesn't begin to get fulfilled, it will reverse on us. That could happen rather quickly and I'm concerned about that.

A couple of the pillars of the recovery we're hoping for strike me as being a little suspect. Autos are a big ticket discretionary item and as such they're fickle. The numbers aren't there yet and we're going to have to see them, I think, before we can be sure of them. Also, in the case of exports, the G-7 countries are largely in a slowing mode and we're in a stronger dollar period, so I have to worry a little about the extent and timing of how that is going to run. As for inflation, I am very chagrined and disappointed that the core rate is so sticky so far. And as far as the Greenbook's projection goes, the staff doesn't show it improving meaningfully until the second half of 1992, and that's a long time away. I hope that David's inescapable logic is correct and that Gary Stern's is correct; I think there's good reason to hope that it may be. But we should have been seeing it by now and we haven't as yet.

So, where do the risks lie? In which direction are they liable to fall? It seems to me that Dick Syron and Ed Boehne were probably right that they are approximately symmetric right now. But I would like to close with this point: While the risks may be symmetric in both directions, I don't think the consequences are. It seems to me that the potential consequences of an error on the down side are substantially more severe if we don't get--or if there is a significant delay in getting--the recovery. The banking system, as John LaWare reminds us frequently and correctly, is shaky. We hope to get reform, which I think might well go away if the economy doesn't improve. The budget deficit could really spiral up, with all sorts of consequences. So, while the risks might be symmetric, we should be very conscious and especially alert to the concern about the asymmetry of the consequences.

CHAIRMAN GREENSPAN. Thank you. We will now move on to Don Kohn.

MR. KOHN. Thank you, Mr. Chairman. It's late, and Governor Mullins gave half my briefing, so I'll try to summarize what I have left. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Don?

MR. SYRON. One, coming back to the point that David raised that every financial market indicator under the sun seems to be indicating a rebound: Just looking at the stuff that came out, the comments [about] the stock market really were quite persuasive. I was wondering what previous history there is of a false positive with this degree of [a stock market] move.

MR. KOHN. None.

MR. MULLINS. An increase in the middle of a recession; [have you] looked at it?

MR. KOHN. I think the largest false positives previously of an up movement in the stock market in the middle of a recession have been about 5 percent.

MR. MULLINS. This is the first you see?

MR. SYRON. But this would be by some order of magnitude.

CHAIRMAN GREENSPAN. There are always firsts.

MR. MULLINS. It's like a yield curve predicts and rebuilds--

CHAIRMAN GREENSPAN. Any other questions for Don? If not, let me get started. I have nothing that's significantly at variance with what I've heard around here. I do think we can look at the policy outlook as essentially representing more of a bimodal distribution in which the probabilities of events are probably discrete rather than continuous. By far the highest probability at this stage seems to be that the healing process that we've been observing in recent weeks will continue and will gradually lead into a bottoming out and an economic upturn. A crucial issue that Governor Angell raised is the question of the saving rate. One way of looking at that process is that what often has been the case in such periods is that we get a run-up in existing home sales, which in turn engenders realized capital gains financed by mortgage debt, which in turn creates funds that the surveys suggest go disproportionately into big ticket consumer items. It turns out, obviously, that the national income accounts show a rise in consumption without a rise in disposable income and, therefore, a decline in personal savings. And since we're starting from a saving rate that is probably slightly north of 5 percent, we do have some possibility of getting [added] consumer spending even in the context of what is clearly a very deficient income flow. In that context it's interesting to note that a substantial part--perhaps almost all--of the fluctuation of the GNP since the fourth quarter is gross motor vehicle products, meaning auto sales plus the steel and all the various parts; GNP ex gross motor vehicle products for all practical purposes was zero or maybe a slight plus in the fourth quarter and will be roughly zero in the first and second quarters of this year. That is another way of saying that it's a recession without the capital goods relationships that historically were the major elements that gave us much deeper declines than we are seeing currently.

That leads me to the second probability, which is not [on a continuum], but one in which we could see a failure of the recovery to take hold, continued pressures on profit margins, business confidence falling, and finally a real dive in capital appropriations, which we haven't seen. And that would induce a secondary phase of the recession, which would deepen rather considerably. The probability of that is at this stage still rather moderate to small, but in my judgment non-negligible.

I think that leads us then to a policy stance that really gets to this point: If the economy is healing and recovering, then certainly no further easing is required at this stage; but if we get a cumulative erosion, which leads to clear evidence that the capital goods markets are beginning to cave, then I think the proper action is probably a significant drop in the discount rate. Were the economy to go in that direction and those events were emerging, obviously from the discussion we had earlier in this meeting about enhanced consultations, that would clearly be on the table. As a consequence, I conclude that as a practical matter, what we're dealing with at this stage is a symmetrical directive because anything veering off that strikes me as something that would be likely caused by events about which it would be useful to have a consultation of this Committee.

There are other issues that we have to be aware of over the longer term. We have finally jump-started M2 back into the range, and the existing projections suggest that it will stay there--perhaps somewhat on the higher side rather than in the middle. And I think we may very well have to contemplate, though not necessarily immediately, that our next move will be not down but up. As I look at it, I would say that we have done exceptionally well in keeping money and credit aggregates over the last two or three years on a trend which, unless we are all wrong about inflation being fundamentally a monetary phenomenon, will lead over the next two or three years to a marked decline in the rate of inflation. And at this particular point we have the luxury in a sense of responding to the recession fairly aggressively because we've had a constricted money supply. If this economy begins to recover and we begin to run into accelerated money supply growth, it would be wise for us to be careful not to let it get away from us, having spent so much time trying to get it down into this particular area.

The one interesting problem, which I don't know how to handle at this stage, is the exchange rate. We cannot explain the exchange rate in terms of our standard variables. It looks to me as though what we have is an historic discontinuity in judgment about the nature of politics and property rights in the United States and hence the value of holding dollar claims relative to the other major currencies. I'm not overly confident that the dollar is going to reverse at this stage. I have concerns similar to those Governor Mullins [mentioned]. And the only argument at this point that raises the question of whether we should move rates lower for reasons other than business or economic activity is if we [were to] begin to view our exchange rate as creating some form of problem for us. I think that's well in the future and a very minor issue--certainly not something that is contemplated in the intermeeting period, but something that may surprise us and become the other side of the problem we have been so concerned about for so long: mainly, an exceptionally weak dollar.

So, in summary, I would say as a practical matter that I see very little alternative at the moment other than alternative "B" with symmetric language. Obviously, if there's a strong desire around the table for asymmetry, which I don't feel frankly, that's not a big deal one way or the other; it's more a practical than a strategic issue. But for the moment I would stay where we are, watch the data as closely as we can, and unless we see this cumulative deterioration taking form, I would suspect that we ought to be patient and wait for the economy to turn. President Syron.

MR. SYRON. Mr. Chairman, I find myself in complete agreement with your suggestion and encouraged by the mechanism that you suggest. I think that we are probably close to a turning point. You're right that nothing is ever certain. The behavior of the aggregates is encouraging but if we have to move the discount rate, that may well be the way to go particularly in light of what may be nonfinancial factors accounting for changes instead of world spirits about the United States [leading to an] appreciation of the dollar. And I am heartened by your suggestion that if it becomes necessary to move the funds rate significantly as well, further consultation would be appropriate at that time. So, I completely support your suggestion.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Mr. Chairman, I can accept your suggestion for "B" symmetric. I suppose I have a slight preference for an asymmetric directive on the side of tightness in that during periods of recession as we approach the trough it's very important to guard against easing during such a period. I suppose the reason that I'm at that position is that I notice the staff has a 6.9 percent nominal GNP growth path from Q2 1991 to Q2 1992, and 6.9 percent is a pretty heavy dose. Now, I guess if I thought it were going to be 1 percent less, at 5.9 percent, I would feel more comfortable; I'd feel more comfortable if it were going to be at 5 percent because at this stage it's not the CPI or the fixed-weight deflator that counts, it's the GNP deflator that counts in terms of the crowding out [effect]. That is, the only crowding out that occurs is on the GNP deflator. And if the GNP deflator is at 3 percent and we have 5 percent nominal, we have plenty of room. I just feel that 5 percent is more consistent with our progress toward price stability. I do agree, Mr. Chairman, that there is some bimodal possibility here, but the most likely way that a significant downturn could occur it seems to me is for the bond markets and the capital markets to become discouraged in regard to our progress on inflation. And a run-up in long-term rates could be unfortunate in the fragile situation that we're in. Now, I also agree with you and Governor Mullins that the exchange value of the dollar is more apt to be strong rather than weak later and I do agree that at some point in time that might be a factor, particularly if the price of gold were plummeting below $330 an ounce or something like that. It's always possible that we could find ourselves in that environment, but I think we could take action at that time because the bond markets would be on our side. So, I would prefer to be asymmetrical toward tightness. I'm not giving much signal that I'm very enthusiastic about that other group changing that other tool.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I could support your recommendation of alternative B, no change in policy, since it certainly appears that the economy will be recovering at a satisfactory pace several months from now, especially in light of our recent policy moves. I also have a preference for a policy directive that is symmetrical. Before any further policy action is taken, consideration of the inflationary implications of such a policy seems necessary. I think the persisting high long-term interest rates are indicative of the market's concerns about inflationary pressures in the future as well as its perceptions of the strength of the economy. Given that a near-term turnaround in the economy is being widely forecast, such precaution appears especially warranted at this time. Also, forecasts of a turnaround would seem to be more credible now that war-related uncertainties have been substantially reduced. So, I would support alternative B and symmetric language.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, several months ago we sat around this table as we eased policy and reminded ourselves--and several people participated in this--that we had better be ready when the time came to avoid the mistake that we usually have made in the past in not tightening soon enough. I was prepared to deliver that same talk again and also to throw in a caveat that we ought not pay much attention to our favorite economic indicator, the level of employment. You made essentially the same talk and made all the points I thought were pertinent. So, I very much agree with you that we ought to stay with "B" with a symmetrical directive. I also agree that if we move in either direction, it would be desirable to meet and talk about it.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I agree entirely with your recommendation that we make no policy change at this time. However, given my view of the economy and the risks to the economy, I would slightly prefer an asymmetric directive in the direction of ease. But it's a close call and I would certainly support a symmetric directive.

CHAIRMAN GREENSPAN. President Keehn.

MR. BOEHNE. "B" symmetrical.

CHAIRMAN GREENSPAN. Si.

MR. BOEHNE. Oh, sorry! I apologize.

CHAIRMAN GREENSPAN. If that's a proxy--

MR. KEEHN. I would be in favor of alternative B. I would have had a slight preference for asymmetric language in favor of easing but I think your comments with regard to consultation in the event of accelerating deterioration deal with that and, therefore, I support your position.

MR. BLACK. Si is the first fellow who has ever had a hired gun to speak for him at a meeting!

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I strongly support your proposal. I think it's important that we go to a symmetric directive at this point, in part because I have an ongoing bias in favor of that largely to let evidence accumulate before we act. But in these circumstances, as I suggested earlier, I think we do want to maintain a sense of balance and a perspective as we go forward here. And I think the symmetric directive is appropriate.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I support the recommendation of "B" symmetric for all the reasons that you have so much more logically and eloquently stated than I.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Oh, I do get to go before Ed! Maybe I can be briefer: Yes.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I yield to President Keehn!

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. To the extent that we have or believe that we have countercyclical capabilities, it seems to me they rest on our credibility; that's the only clothes we have to wear. And our credibility depends largely on our actions that support price stability. We have no price anchor; we're not tied to a price level directly. And the only thing I think we can do over time, as I have said many times before, is to maintain money growth at a low rate. That's a long-winded way of saying that I think we ought to watch money growth and I support your recommendation.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. "B" symmetric.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I support "B" symmetric, and I think we may well get Governor Angell's 5 percent nominal GNP as it is, although it's still not inconceivable to me that we may need a gong.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I'm happy to support "B" symmetric but I would personally have a slight preference for asymmetric toward ease because of the asymmetry I see in the consequences of a shortfall.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. I will support "B" symmetric.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. "B" symmetric.

CHAIRMAN GREENSPAN. Would the Secretary read an alternative B symmetric directive for purposes of a vote?

MR. BERNARD. "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from March through June at annual rates of about 5-1/2 and 3-1/2 percent, respectively."

MR. KOHN. Mr. Chairman, the only issue I'd raise is whether, given your tendency not to move, "might" would be a better word than "would."

CHAIRMAN GREENSPAN. I think I'll change it to "might."

MR. BLACK. It would be "somewhat" still?

CHAIRMAN GREENSPAN(?). Yes.

MR. BERNARD. "Somewhat greater or somewhat lesser...might be acceptable."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Black	Yes
President Forrestal	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Mullins	Yes
President Parry	Yes.

CHAIRMAN GREENSPAN. Thank you. Our next meeting is May the 14th. Let's adjourn for lunch.

END OF MEETING